LOCAL INFRASTRUCTURE FINANCING

(100-72)

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC DEVELOPMENT

OF THE

COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON

H.R. 3807

TO REQUIRE THE SECRETARY OF COMMERCE TO STUDY LOCAL FINANCING PRACTICES FOR PUBLIC WORKS PROJECTS, AND TO PROVIDE MORE LENIENT TREATMENT FOR SMALL ISSUERS OF TAX-EXEMPT BONDS WITH RESPECT TO THE ARBITRAGE REBATE RULES AND THE PRIVATE ACTIVITY BOND RULES

AUGUST 10, 1988

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100TH CONGRESS
1ST SESSION

H. R. 3807

To require the Secretary of Commerce to study local financing practices for public work projects, and to provide more lenient treatment for small issuers of tax-exempt bonds with respect to the arbitrage rebate rules and the private activity bond rules.

IN THE HOUSE OF REPRESENTATIVES

DECEMBER 18, 1987

Mr. HOWARD (for himself, Mr. HAMMERSCHMIDT, Mr. OBERSTAR, Mr. CLINGER, Mr. ANDERSON, Mr. ROE, Mr. MINETA, Mr. NOWAK, Mr. RAHALL, Mr. DE LUGO, Mr. SAVAGE, Mr. SUNIA, Mr. VALENTINE, Mr. TOWNS, Mr. LIPINSKI, Mr. ROWLAND of Georgia, Mr. GRAY of Illinois, Mr. VISCLOSKY, Mr. LANCASTER, Ms. SLAUGHTER of New York, Mr. LEWIS of Georgia, Mr. DEFAZIO, Mr. PERKINS, Mr. SHUSTER, Mr. STANGELAND, Mr. MOLINARI, Mr. SHAW, Mr. MCEWEN, Mr. SUNDQUIST, Mr. PACKARD, Mr. GALLO, Mrs. BENTLEY, Mr. LIGHTFOOT, Mr. INHOFE, and Mr. UPTON) introduced the following bill; which was referred jointly to the Committees on Public Works and Transportation and Ways and Means

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A BILL

To require the Secretary of Commerce to study local financing practices for public work projects, and to provide more lenient treatment for small issuers of tax-exempt bonds with respect to the arbitrage rebate rules and the private activity bond rules.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Local Government Infrastructure Financing Improvement Act of 1987".

SEC. 2. FINDINGS.

The Congress finds that—

(1) the adequacy and reliability of local public works facilities is essential to ensure a sound foundation for sustaining and expanding economic development and growth;

(2) the maintenance, repair, and expansion of existing public works facilities directly affects a locality's ability to retain its economic foundation and accommodate future growth;

(3)(A) Federal categorical grants programs targeted to assist local communities to build and maintain public works facilities have been steadily declining;

(B) general revenue sharing has been eliminated; and

(C) the prospect for increasing Federal assistance for public works facilities appears unlikely;

(4) performance standards for public works facilities are becoming more and more stringent, especially for environment and health-related facilities such as wastewater treatment plants, water treatment plants, and solid waste disposal facilities;

(5) local governments must continue to meet the performance criteria referred to in paragraph (4) or face the imposition of stiff fines and penalties;

(6) units of local governments must take greater responsibility for financing and managing essential public works facilities;

(7) local governments must use a larger share of local resources to pay for public works projects, including a greater reliance on tax exempt public works facility bonds; and

(8) Federal laws regulating the issuance and use of tax exempt bonds are so cumbersome and expensive to administer that many local governments are no longer using the bond markets to their best advantage, thus deferring essential maintenance, repair, and construction of public works facilities.

SEC. 3. TECHNICAL ASSISTANCE.

Section 301 of the Public Works and Economic Development Act of 1965 (42 U.S.C. 3151) is amended by adding at the end thereof the following new subsection:

"(g) FINANCING ALTERNATIVES.—The Secretary shall provide to local governments technical assistance with respect to financing construction, repair, and expansion of public works facilities, including provision of information necessary to familiarize local governments about the use and

availability of tax exempt public works facility bonds for such financing.".

SEC. 4. LOCAL GOVERNMENT INFRASTRUCTURE FINANCING PRACTICES.

Title VII of the Public Works and Economic Development Act of 1965 (42 U.S.C. 3211-3226) is amended by adding at the end thereof the following new section:

"SEC. 717. LOCAL GOVERNMENT INFRASTRUCTURE FINANCING PRACTICES.

"(a) BIENNIAL REPORTS.—The Secretary shall prepare and submit to the Committee on Environment and Public Works of the Senate and the Committee on Public Works and Transportation of the House of Representatives a biennial report which—

"(1) assesses current financing practices used by local governments to fund the construction, repair, and expansion of public works facilities;

"(2) determines the percentage of the total costs of such construction, repair, and expansion which are paid with local funds; and

"(3) determines the extent of local government reliance on tax-exempt municipal bonds to finance such construction, repair, and expansion.

"(b) DEADLINE FOR 1ST REPORT.—Not later than 1 year after the date of the enactment of this section, the Sec-

retary shall submit to the committees referred to in subsection (a) the first biennial report under this section.

"(c) PUBLIC WORKS FACILITY DEFINED.—For purposes of this section, the term 'public works facility' includes a wastewater treatment plant, water treatment plant, solid waste disposal facility, public road (other than a highway eligible for Federal assistance under title 23, United States Code), publicly owned airport, public mass transit facility (including transit vehicles and other rolling stock), and publicly owned building.".

SEC. 5. SPECIAL RULES FOR GOVERNMENTAL UNITS WHICH ISSUE SMALL AMOUNTS OF TAX-EXEMPT BONDS.

(a) EXEMPTION FROM ARBITRAGE REBATE RULES TO APPLY TO GOVERNMENTAL UNITS WHICH ISSUE $25,000,000 OR LESS OF TAX-EXEMPT BONDS.—Subparagraph (C) of section 148(f)(4) of the Internal Revenue Code of 1986 (relating to exception for small governmental units) is amended by striking out the dollar amount contained therein each place it appears and inserting in lieu thereof "$25,000,000".

(b) SMALL ISSUERS MAY USE UP TO 25 PERCENT OF BOND PROCEEDS FOR PRIVATE USE WITHOUT TREATMENT AS PRIVATE ACTIVITY BOND.—Subsection (b) of section 141 of such Code (relating to private business tests) is

amended by adding at the end thereof the following new paragraph:

"(10) EXCEPTION FOR SMALL GOVERNMENTAL ISSUERS.—

"(A) IN GENERAL.—In the case of an eligible small governmental issuer, paragraphs (1), (2), and (3) shall be applied by substituting '25 percent' for '10 percent' each place it appears with respect to any issue designated by such issuer for purposes of this paragraph.

"(B) ELIGIBLE SMALL GOVERNMENTAL ISSUER.—For purposes of subparagraph (A), the term 'eligible small governmental issuer' means any issuer if the reasonably anticipated amount of tax-exempt obligations which will be issued by such issuer during the calendar year does not exceed $25,000,000. Rules similar to the rules of section 265(b)(3) shall apply for purposes of determining the amount of bonds issued by an issuer.

"(C) $25,000,000 LIMITATION.—Not more than $25,000,000 of bonds issued by an issuer during any calendar year may be designated by such issuer for purposes of subparagraph (A)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to bonds issued in calendar years after 1986.

LOCAL INFRASTRUCTURE FINANCING

WEDNESDAY, AUGUST 10, 1988

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ECONOMIC DEVELOPMENT,
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:42 a.m., in room 2167, Rayburn House Office Building, Hon. Gus Savage [chairman of the subcommittee] presiding.

Mr. SAVAGE. This hearing of the subcommittee will come to order.

We have just been notified of a second vote. It may be better to break right now, rather than to start for only a few moments before we have to leave for this second vote. We anticipate that it will then be some 60 minutes before we have another vote, so we will then be able to really get this hearing under way.

Before we recess for this second vote, I want to recognize the ranking Republican member of our full committee, the Honorable John Hammerschmidt.

Mr. HAMMERSCHMIDT. Thank you very much, Mr. Chairman. Since I have to go on to another meeting, I appreciate your recognizing me now.

As I reported at the full committee last week, the Minority is very pleased to have designated our distinguished colleague from Ohio, Congressman Bob McEwen, as the new ranking member of the Subcommittee on Economic Development. Few Members of Congress are better qualified to serve in this important position. The subcommittee will greatly benefit from his experience, intelligence, and leadership.

Representing a Congressional district that includes rural communities in Appalachia, he knows well the attendant problems of these areas. Throughout his tenure on the committee, he has been a visible leader for rebuilding America's infrastructure, and an outspoken and effective advocate for strong action to address the Nation's growing needs, which leads me to the subject of the hearing today.

Let me comment just briefly. Perhaps the single greatest source of financing for the construction and improvement of local public works facilities is the tax-exempt bond market. Unfortunately, at a time when we are trying to increase spending on rebuilding our Nation's infrastructure, we are in many ways thwarting that effort through Congressionally mandated limitations and restrictions on tax-exempt bonds.

H.R. 3807 is intended to ease those restrictions on small issuers of tax-exempt bonds and to insure that local communities have the knowledge and expertise to take advantage of this important revenue source. The authors of the legislation, our former chairman, Jim Howard, and our distinguished colleague, Bill Clinger, are to be commended for their efforts in this regard.

The testimony of today's witnesses will help us determine the correct course of action to insure that communities can continue to self-finance projects at a reasonable cost. This is critical if we are to provide the public service that our Nation's citizens will require in the decades to come.

Thank you very much, Mr. Chairman, for allowing me to make that opening statement.

Mr. SAVAGE. Thank you, and let me just add that I certainly concur in my colleague's comments, but I will refrain from elaboration until after this brief recess.

[Recess.]

Mr. SAVAGE. The subcommittee will please come to order.

Before we begin this morning's business, I want to welcome Congressman Bob McEwen as the ranking Republican member of this subcommittee and say that I look forward to working with him in his new capacity. As a long-time member of the Subcommittee on Economic Development, Bob has consistently supported efforts to improve the programs of both the Economic Development Administration and the Appalachian Regional Commission, and has worked to help the economically distressed areas of our Nation.

He replaces Congressman Clay Shaw, who was recently appointed to the Ways and Means Committee, and thus, had to give up his membership of the Public Works and Transportation Committee. It has been a pleasure working with Congressman Shaw, and I shall miss him and his cooperation, knowledge, and expertise on this subcommittee. However, I feel sure that his unique talents and skills will be well utilized and be of great assistance to the work of the Ways and Means Committee, and I wish him well in his new position. Let me make it clear that I do not consider Bob to be second best to Clay. He is just younger and more photogenic, if not as wealthy. [Laughter.]

Mr. SAVAGE. Let me just deviate for a moment to explain, since I understand we have several mayors who will be testifying this morning, that we Members of Congress, when we are in your cities acting as though we are in charge—you have to understand that really the clock is in charge here. When two lights go on, that summons us to the Floor, and we have to leave and go to the Floor to vote. Otherwise, when we return home on weekends, the local press will have stories about us. So, you will have to excuse us periodically when you hear those bells. Shortly after they sound, we will have to recess to go vote.

Now then, the purpose of our hearing today is to discuss proposals contained in H.R. 3807. The provisions of this bill would make it easier for small and medium sized local governments to participate in municipal bond markets and to finance infrastructure and other projects that they consider are necessary for economic growth and development. H.R. 3807 would add two new provisions to the Public Works and Economic Development Act. One new pro-

vision would provide technical assistance to local government officials on how to deal with the complexities of using tax-exempt bonds to finance public works facilities. The other would call for the Secretary of Commerce to study local government public works financing practices and to report to our committee and the Senate Environment and Public Works Committee. I do not understand these two to be controversial or partisan. However, the bill also would amend the Internal Revenue Code in two substantial ways.

First it would raise from $5 million to $25 million the amount of tax-exempt bonds that a small governmental unit may issue without falling under the requirement to rebate arbitrage profits to the Federal Government. As many of you know, prior to the 1986 Tax Reform Act, local governments could invest the proceeds of tax-exempt bond issues in higher yielding investments for a period of up to three years, and could use the profits earned to help pay for the project. I believe this also could encourage bond issues and aid activity of private financial firms.

Secondly, this bill would increase from 10 percent to 25 percent that amount of tax-exempt government bond proceeds that may be used for non-governmental activity or for private purposes without triggering treatment of the bond issue as a taxable private activity bond. This is limited to government issuers whose reasonably anticipated amount of tax-exempt obligations to be issued during a calendar year is $25 million or less. Also, it caps at $25 million the amount of bonds to which the issuer may apply the 25 percent private use test in any year. However, I am concerned that it also could permit continued and expanded abuses of tax-exempt bond issuance for non-governmental purposes. Nonetheless, we must recognize that over the past two decades, capital investment in public works facilities by all levels of government has been declining. The result is increasingly obvious that we are shortchanging the present and future quality of our lives, as well as our national productivity and output in this way. This was spelled out in no uncertain terms in the final report to the National Council on Public Works Improvement. The Council's first and foremost recommendation was that there be a national commitment shared by all levels of government and the public and private sectors to vastly improve our Nation's infrastructure. Such a commitment could require an increase of up to 100 percent in the amount invested each year in new and existing public works. Clearly these are costs that must be borne by everyone to some degree, and a wide range of revenue sources and funding techniques must be utilized.

Under the circumstances, it is time for the Federal Government and the States to reassess the impact of fiscal and tax policies that impede the revenue raising capabilities of or impose undue costs and complex red tape on State and local governments.

That is why we shall today consider H.R. 3807. There is a growing evidence that tax changes enacted over the past several years in a number of procedures relating to use of tax-exempt bonds, culminating with the Tax Reform Act of 1986, have possibly impaired the ability of many local communities to raise the necessary capital to meet infrastructure needs. Those changes were aimed at curbing abuses in the use of State and local bonds for private, rather than

public purposes, as you know, and to control the volume of State and local tax-exempts resulting in high Federal revenue losses.

Finally, let us face this fact: H.R. 3807, considered by us today, is not likely to go far in this Congress, for we share jurisdiction with the Ways and Means Committee, which presently has its hands full with technical changes legislation. Thus, I am not certain of our timeliness, yet it is important to keep a dialogue going on this important matter, and it is important that we look thoroughly at all the issues and complexities involved and hear from witnesses from the local level who must cope with the increasing difficulty of financing projects because of the declining assumption of Federal responsibility. For the record, let me note that I am, at least until this point, a co-sponsor of H.R. 3807, but I have serious growing doubts regarding a portion of its provisions.

Now let us hear any comments by our esteemed new ranking minority member, Bob McEwen.

Mr. MCEWEN. Thank you, Mr. Chairman. I also want to join you in welcoming the witnesses who have taken the time to be here this morning, especially with the difficulty we have had in beginning due to the Floor action. I thank you for your gracious comments, and I am sure that those who have assembled here today understand the gravity of the problems that are facing in local infrastructure today and are anxious to help us in devising relief and solutions to these problems. You made reference to the changes in the committee, Mr. Chairman, and it is a pleasure to have this opportunity to join you in this position in the closing days of the 100th Congress. The programs under the jurisdiction of this committee, those of EDA and ARC have been a tremendous benefit to the Nation and particularly, to our region of the Nation. It is fitting that we begin to wrap up the subcommittee's activities with an issue that I believe to be the focal point of attention for the next Congress, that of local infrastructure financing.

The subcommittee is convened in order to hear the testimony on H.R. 3807, the Local Government Infrastructure Financing Improvement Act. The goal of this legislation is well known, to provide the small and local governments with the means to raise the monies necessary to begin or improve basic infrastructure projects in their areas.

Specifically, the bill allows local governments the flexibility to use the tax-exempt bonds for public works projects. Over the years, local governments have increasingly been urged to seek new and innovative ways to fund their own projects as opposed to relying upon the Federal Government. Many of their traditional sources of revenue have either been completely lost or severely reduced, including the general revenue sharing, highway and airport trust funds, EPA construction grants, EDA and ARC funds, as well as others. Yet these same government units are expected to maintain over 70 percent of our Nation's highways, not to mention the public construction projects for which they are responsible, such as sewers, schools, fire houses, and the list goes on and on. Local governments take responsibility for financing these necessary projects and we must make sure that they have the tools with which to meet these responsibilities.

I am sure that we are all well aware of the recent EPA deadline for complying with the Clean Water Act. Local governments are now responsible for meeting stricter requirements for waste water treatment, but they are supposed to pay these bills for the new plants required by the tougher standards without government assistance and also to meet Congressional mandates. Small communities have a tough time even raising the minimal amounts necessary for State and local governments to come up with partial funding.

Over the past year, I have heard from a variety of local government officials with regard to this particular legislation and other local infrastructure financing problems, the county engineers, mayors, city managers, county commissioners, village councils, and more. Many would like to utilize bond financing, but are prevented by the many restrictions on its use. We believe that an additional 36 percent of local governments that are currently issuing bonds, could enjoy benefits resulting from this proposal.

This bill would raise the threshold for exemptions from $5 million to $25 million and will allow small and medium public works projects to begin. The lessened restrictions will encourage others to turn to bond issuance as a source of revenue, as well as encourage general investment.

Communities everywhere are facing the same problem, they feel as if they are being taxed more for less service. The Local Government Infrastructure Financing Improvement Act is one measure that will allow localities to raise revenue without raising taxes. Our experts here today can help us and provide us the expertise necessary to make sure that it accomplishes that goal. I welcome them. I apologize again for the delay that we have unavoidably faced. I appreciate their consideration and tolerance and look forward to their testimony. Thank you, Mr. Chairman.

[Mr. McEwen's prepared statement follows:]

STATEMENT OF CONGRESSMAN BOB MCEWEN

Mr. Chairman, let me begin by joining you in welcoming our witnesses who took time out of their busy schedules to testify before this panel today. I am sure that they, as well as the members of this Subcommittee, recognize the gravity of the problems facing local infrastructure today, and are anxious to help us in devising both relief and solutions. I appreciate all of you being here.

It is a pleasure for me to have this oportunity to serve with you, Mr. Chairman, in this leadership position during these closing days of the 100th Congress. Programs under the jurisdiction of this Subcommittee, those of the Economic Development Administration and the Appalachian Regional Commission, have been of tremendous benefit to the citizens of our country and of personal interest to me.

It is fitting that we begin to wrap up the Subcommittee's activities with an issue I believe will be the focal point of attention during the next Congress: local infrastructure financing. The Subcommittee has convened in order to hear testimony on H.R. 3807, the Local Government Infrastructure Financing Improvement Act. The goal of this legislation is well known—to provide small, local governments the means to raise additional money to begin, improve or repair basic infrastructure projects in their area. Specifically, this bill will allow local governments much more flexibility in the use of tax exempt bonds for public works projects.

Over the years local governments have increasingly been urged to seek new and innovative ways to find funding for their projects, as opposed to relying on the federal government. Many of the traditional sources of revenue have either been completely lost or severely reduced, including general revenue sharing, highway and airport trust fund money, EPA construction grants, Economic Development Agency and Appalachian Regional Commission funds and more.

Yet these same government units are expected to maintain over 70 percent of the nation's highway mileage, not to mention numerous other public construction projects for which they are responsible, including roads, sewers, schools, firehouses, etc. Local governments take responsibility for financing these necessary projects, but we must make sure they have the tools to meet these responsibilities.

And I am sure we are all well aware of the recent EPA deadline for complying with the Clean Water Act. Local governments are now responsible for meeting stricter requirements for wastewater treatment, but how are they supposed to pay the bills for the new plants required by the tougher standards? Small communities have a tough time even raising minimal amounts required for projects where the state and federal government provide partial funding.

Over the past year I have heard from a variety of local government officials with regards to this particular legislation and other local infrastructure financing problems—County Engineers, Mayors, City Managers, County Commissions, Village Councils and more. Many would like to utilize bond financing, but are prevented by the many restrictions on its use. At least 36% more local governments, of those who currently issue bonds, would enjoy the results of investment profits if this proposal were enacted into law. And in addition, many more local governments would consider using bonds for the first time ever, and utiizing this type of self-financing.

In fact, I heard from one treasurer of a school board who provides a perfect example of why this legislation is needed. The Talawanda City School System, Oxford, Ohio, issued $13,650,000 of construction debt in 1987, to construct and improve schools. Because the issuance was over $5 million, that district was forced to comply with arbitrage rebate requirements and return to the government profits made by investing the bond proceeds. If the school system had been exempt from the arbitrage rebate requirements, the funds available would have provided four additional classrooms.

This bill would raise the threshold for exemption from the arbitrage rebate restrictions from $5 million to $25 million and will allow both small and medium public works projects to begin. The lessened restrictions will encourage others to turn to bond issuance as a source of revenue, as well as encourage general investment.

The legislation will also direct the Secretary of Commerce to provide technical assistance to local governments on the use and availability of tax-exempt public works facility bonds so that everyone will know how to use them, if they desire. And in addition, the Secretary will conduct a study of local public works financing practices, and report the findings to this Committee. At that time we will evaluate the various financing alternatives and do what we can here to make them more viable. We must encourage and promote financing alternatives, and make sure local governments are aware of and take advantage of these alternatives.

Recent Congressional action to correct abuses in the tax exempt bond arena has to a large extent been equivalent to throwing the baby out with the bath water. Our efforts to fix one problem has contributed to making a bad situation even worse. By the same token, we reacted to a situation created by state and local governments for which they must assume responsibility and for which they must clean up.

Communities everywhere are facing the same problem—they feel as if they are being taxed more for less service. The local Government Infrastructure Financing Improvement Act is one measure that will allow localities to raise revenue without raising taxes. Our experts here today will be able to provide us with expertise and more details of how this very important proposal can be utilized in the most effective way.

Mr. Chairman, I am looking forward to the comments of our witnesses and with that I yield back to you.

Mr. SAVAGE. I want to also welcome a new member to our subcommittee, Congressman Payne, from Virginia. At this time we will entertain any comments or observations from my good colleague, Mr. Payne.

Mr. PAYNE. Thank you, Mr. Chairman. I appreciate the kind introduction and I would simply like to say that it has become very apparent to me, since I have been in Washington, how important the work of this Subcommittee on Economic Development is, and I look forward to serving with all the other members and hope that we can achieve some of the goals that need to be addressed relative

to the issues of infrastructure that are confronting us throughout the United States today. Thank you.

Mr. SAVAGE. Mr. Clinger?

Mr. CLINGER. Thank you very much, Mr. Chairman. Before getting underway, I would just like to extend my congratulations to my friend and colleague, Bob McEwen on his appointment as ranking Republican on this most important subcommittee. I have worked very closely with Bob over the years, and I know that he is deeply committed to improving our Nation's public works and that he will use his position on this subcommittee to continue speaking out in favor of increased governmental investment and also in behalf of getting our trust funds out of the unified budget, which he has taken such a fine leadership role in.

Mr. Chairman, this morning's hearing on H.R. 3807, Local Government Infrastructure Financing Improvement Act, is important to the national debate regarding the future direction of government investment in our public works. The bill was introduced by our former chairman, Jim Howard, who recognized that outside forces were beginning to impinge on local government's ability to finance capital construction and maintenance.

The genesis of H.R. 3807 rose from the fact that Jim Howard was singularly devoted to the work of this committee in advancing the cause of public works, and more than most of his peers, he recognized that our quality of life, our economy, and our ability to compete in the international marketplace were tied directly to the quality of our infrastructure. It was Jim Howard who first recognized that the old way of doing business, that is the Federal grant and aid programs popular in the sixties and early seventies, was threatened by new spending priorities and budget constraints. During the 98th and 99th Congresses, Jim Howard introduced legislation that sought to respond to this trend by developing a new and innovative spending program aimed at helping State and local governments keep up with demand on local public works. At the same time he was offering this legislation, however, we had a little item called "Gramm-Rudman," which came upon the scene and completely derailed any hope of moving these bills forward.

Coincidentally, however, the Tax Reform Act came along, and with very little consultation with this committee, the House and Senate committees principally responsible for writing tax legislation incorporated a number of provisions that drastically affected the work of just about every sector of our economy, including the business of local government. In my opinion, the Act's treatment of local government is very counterproductive. Jim Howard shared this view, and in late 1987, introduced H.R. 3807 to help relieve some of the more onerous provisions imposed on communities desiring to use bond financing for public works projects.

H.R. 3807 increases the threshold for performing arbitrage rebate calculations from $5 million to $25 million. It reinstates the former private purpose allowance of 25 percent, and it directs the Department of Commerce to report to Congress on the types and amounts of financing used by local governments to build and maintain their public works and to offer technical assistance on the use of tax-exempt financing.

Earlier this year, the National Council on Public Works Improvement issued their final report entitled "Fragile Foundations." Their study is very well written and documented, and one of their major recommendations was the removal of "unwarranted limitations on the power of State and local governments to finance public works." I believe, Mr. Chairman, that H.R. 3807 would help achieve this goal.

Last year the Investigations and Oversight Subcommittee, on which I serve, held a hearing on State and local government infrastructure financing. In their testimony, just about every witness cited the Tax Reform Act as an impediment and counterproductive to the needs of local government. Even though individuals were quick to admit that certain abuses had occurred in the bond markets, it was clear that all communities, large and small, now suffer because of the severity of the new tax rules. So, on the one hand, we are cutting back on the traditional funding programs of the Federal Government and asking the State and local governments to do more of their own infrastructure financing. On the other, we are taking away the tax incentives to permit them to do that.

Mr. Chairman, H.R. 3807 represents a small first step to help local governments meet present and future public works challenges. It is, however, just a step. The next Congress, I believe, will have to face the bigger challenge of providing some form of direct assistance to communities. It is either that, or Congress must dispense with the present practice of mandating programs to be carried out by local communities while not giving them the resources or the tools to do the job.

Thank you, Mr. Chairman, for calling this morning's hearing. I appreciate the leadership and cooperation that you have extended to all members of this subcommittee, and I look forward to hearing from our witnesses.

Mr. SAVAGE. Mr. Boehlert?

Mr. BOEHLERT. Thank you, Mr. Chairman. As a former county executive, I am acutely aware of the plight of our mayors and county officials as they try to finance these important projects. Rather than sit idly by and be witness to the perpetuation of the problem, I would like to be part of the solution, so I am a co-sponsor of H.R. 3807. I do welcome this hearing, and I welcome our distinguished panelists this morning. Thank you.

Mr. SAVAGE. Thank you.

We have a statement from Congresswoman Bentley that will, without objection, be entered into the record at this point.

[Mrs. Bentley's prepared statement follows:]

STATEMENT OF THE HONORABLE HELEN DELICH BENTLEY

Thank you Mister Chairman and ranking minority member, Mister Shaw, for calling this hearing today on this issue.

There is good reason for this committee to be concerned with the condition of the nation's infrastructure.

We are all too familiar with bridge collapses, water line ruptures, treatment plant inadequacies, and the accelerating decay of our local and interstate road system.

We need to look to the financial means to restore the underpinnings of our urban society. I look forward to hearing the pros and cons of H.R. 3807.

The need to help local communities and states to meet the emerging crisis of the decay of our infrastructure is self evident.

It appears that H.R. 3807 is aimed at undoing some of the damage done to local financing capacity by the Tax Reform Act of 1986. There is a temptation to point out that we wouldn't have to undo damage if we didn't do the damage in the first place, but I will resist the temptation.

Of course, the time to have started on the jobs of shoring up our infrastructure was yesterday. Therefore, Mr. Chairman I commend the Committee for scheduling this hearing and I hope that this is the first step in a comprehensive program to solve the national problem.

Thank You.

Mr. SAVAGE. Now I want to welcome one of the two opening witnesses, the Hon. Richard J. Comer, Deputy Mayor of Gary, Indiana, the vibrant city by Lake Michigan which adjoins the district of Illinois that I have represented for the past eight years.

Mr. Comer, I understand that you will be speaking on behalf of the National League of Cities. Before introducing the other panelist, whom I will ask to testify first, let me recognize a colleague who has been a staunch champion for the needs of industrialized and negatively impacted U.S. cities, Congressman Peter Visclosky, who while not a member of this subcommittee, represents the district in which your city is located.

Congressman Visclosky, would you elaborate on the introduction of Mr. Comer?

Mr. VISCLOSKY. Mr. Chairman, I thank you very much for the introduction, and as you pointed out, I am not a member of this subcommittee, although this is the third subcommittee hearing that you have chaired that I have attended, the other two having been in Chicago earlier this year, and I feel as though I am an adopted member. I do want to congratulate the Chairman and to thank him very much for his commitment to economic development at the local and State levels in our country, for his concern for urban problems as well as a genuine commitment to insuring that the infrastructure problems that we face today are going to become a memory during the coming years.

It is a pleasure for me to welcome Richard Comer, the Deputy Mayor of the City of Gary, who is here not only on behalf of the League, but also on behalf of the Mayor of the City of Gary, Tom Barnes. Mr. Comer was educated at Purdue University, studied engineering and public administration, and certainly has a fine appreciation for the problems we are going to be addressing today. As the chairman pointed out, Gary and the surrounding communities have been negatively impacted by the wrenching change in our industrial economy in the Midwest. Tax bases have been reduced, but demand has gone up for city services.

Mayor Comer, I welcome you to Washington and to the subcommittee today.

Thank you, Mr. Chairman.

Mr. SAVAGE. Thank you.

Now I welcome Patrick C. Glisson, Commissioner of Finance for the City of Atlanta, Georgia, which many of us recently learned, to our pleasure, to be a great host city. Mr. Glisson is also Acting President of the Government Finance Officers Association, and speaks in its behalf, too.

Mr. Glisson?

TESTIMONY OF PATRICK GLISSON, COMMISSIONER OF FINANCE, CITY OF ATLANTA, GA, ON BEHALF OF THE GOVERNMENT FINANCE OFFICERS ASSOCIATION; AND HON. RICHARD COMER, DEPUTY MAYOR, GARY, IN, ON BEHALF OF THE NATIONAL LEAGUE OF CITIES

Mr. GLISSON. Good morning, Mr. Chairman and members of the committee. Thank you for your kind remarks about our city. We think we did well, and I appreciate your testimony to that fact.

My name is Patrick Glisson and I am Commissioner of Finance for the City of Atlanta, although I am here representing the Government Finance Officers Association in my capacity as Acting President. This association represents roughly 11,000 public finance professionals who, essentially, take care of the money of the Nation's cities, counties, and States. In that regard, we thank you for the opportunity to give some brief comment on the bill that is before you. We also think that if anyone truly understands the problems that the Tax Reform Act causes for the development of public infrastructure in this Nation, that we, as public finance officials, may have a corner on that market.

The law itself, which was aimed at correcting abuses, went much beyond the mark in getting at its intended purpose. It has limited the financing of what I would term the most basic of public infrastructure projects. I would like to emphasize that our association supports H.R. 3807. We think that it provides significant relief, and we hope that if passed, it will help to reduce some of the serious complications that the 1986 Tax Reform Act has caused for the administration of our cities.

Let me try to highlight some of the things that I hope will help you in deliberating on this piece of legislation and why we think it is beneficial. The first item I want to cover is the modification of the arbitrage rebate exemption. You have a full blown testimony before you—I am going to deviate from that and just give the highlights. Most of you gentlemen seem to have a fair knowledge about arbitrage, and therefore, I will hit that in a very highlighted fashion. Most of the time when arbitrage is mentioned, eyes glaze over and visions of Ivan Boesky pop up. I would prefer that my testimony not lead you in that direction.

Let me first indicate that we feel strongly that the extension from $5 million to $25 million will help thousands of issuers, as I heard Mr. McEwen indicate, and we think that can be done at a very low cost to the Federal Government. There is something that I want to point out on the front end of this discussion, and I would direct your attention to the graph on page two. I really do not want to bore you with numbers, but I think that the graph proves the point that the bill can help a significant number of issuers without impacting greatly on the Federal Government. That is because a very few large issuers amount to a significant portion of the market. Let me highlight a few things that I think the graph demonstrates: bond issues in the amount of less than $5 million represented about 63.04 percent of the total number of bond issues sold in the time frame represented here, but only 8.26 percent of the total volume in terms of dollar amounts of bonds. Therefore, by raising the limit to $25 million, we think that you could add over

2,000 issues and, in fact, that would represent about 87.75 percent of potential issues while impacting, at most, 26.65 percent of the total bond volume. In other words, you can get a large bang for your buck with this legislation.

Let me digress just a moment and talk about how the arbitrage rebate requirement works because I think it is important to understand, and it is really enormously complex. Let me emphasize that at this moment, as we speak, we still do not have arbitrage rebate regulations, so we are dealing in the dark, but in that darkness, what we think will happen can be discussed, at least on the surface.

Let me deal with the very basics and talk about Atlanta and how it works there. Arbitrage has generally had a negative context, and I like to look at the positive context, which would be like this. If Atlanta issued bonds at 7 percent, we would be able to reinvest that at maybe 9 percent, giving you a 2 percent spread, and that amount of money could be utilized to decrease the cost of the project, decrease the volume of bonds that we would sell, and we tend to term that prudent financial management. To give you a very clear example, yesterday we sold bonds, $8 million worth, and sold them at a rate of 7.43 percent. To give you an interesting contrast in what could occur, if I invested it in a somewhat medium range security, I could probably earn 8.5 percent. That is arbitrage. If on the other hand, I invested in a very short term security, I would bring in under the amount that I sold the bonds at, probably 7.23 or 7.25 percent, which is negative arbitrage, if you will. Whether or not we make money, the current legislation requires us to do a great deal of work. Let me discuss a little of what that work entails.

If we do not spend the money in six months, then we have to pay excess arbitrage back to the Federal Government. Excess arbitrage is the difference between what we sold the bonds at and what we invested it at. Let me present to you today the fact that it is impossible to spend that money in that time frame in most governments. Most of those delays are legitimate, they are not designed for us to simply make money at the expense of the Federal Government. If Mr. Lewis were here with us today, he could attest, as I can, that in Atlanta, the charter prohibits me from entering into contracts unless the money is in place, meaning bonds sold and money received. Litigation, inclement weather, labor disputes, and any number of things can limit what allows us to do a project quickly. The fact is, you simply do not build large public works projects quickly.

Let me deal with what the former law provided. It allowed us a three year grace period to construct the project and earn unlimited arbitrage. That's reasonable, and it makes sense. The majority of governments in this country selling bonds to build roads, public buildings, etc., had the time to build the projects and use the excess earnings to lower the cost of what the project would have normally cost. GFOA estimates a normal bond issuance would be on the order of 10 to 12 percent lower if we still had this ability.

Let me deal a minute with the procedural requirements. There are three steps. First, you calculate the arbitrage amount by determining the bond yield. That sounds simple, but under the law it

becomes very complex. Secondly, you have to monitor an investment of funds and how you account for it. Finally, you have to determine the rebate. All of that goes to affect what we think are sound cash management and accounting principles, in the negative. In terms of investment practice, let me cut through a lot of what is in my testimony and give you an example from Atlanta. We have modernized our cash management practices recently. We have done a lot of consolidation which allowed us to invest concentrated dollars in one place and, in fact, to use good cash management practices. The law now requires me to break that back out, and as opposed to using our concentration account approach, I now have to isolate funds and invest smaller amounts of money, which limits our ability to use good cash management practices. In terms of accounting—and I could bore you to death with that subject, but I won't—the fact is, in a general obligation bond, I had one fund for a construction account and one fund for a debt service account. Now, each time I issue debt, I have to create two new funds, with separate accounts within those funds, and I think you can begin to see the compounding affect each time you issue debt. The fact of the matter is, in summary, it has forced the city to undo much of what we thought was very positive cash management and accounting streamlining. In fact, we are now double accounting for things.

The final phase, the rebate calculation, essentially is going to be a new boon for private providers of that service. I have not yet hired staff, I have not yet hired a consultant, but I assure you I will have to do that to meet the requirements of the law, and basically, that is going to cost money. I will probably have to hire at least one employee, and I will probably have to hire a consultant. On one bond issue, I estimate that it will cost us, per issue, about $2,500 per year, simply to do the calculation, whether we ever pay a rebate or not. If you take an $8 million issue at 20 years, that amounts to $50,000 simply to do the administrative paperwork, even if I had negative arbitrage. Over time, the next 10 years, that would cost the City of Atlanta alone, half a million dollars in compliance costs with perhaps no money at all to the Federal Government.

My organization estimates that compliance costs alone in this country will cost $1.1 billion. By the same token, we estimate that the rebates to the Federal Government might, at most, reach $150 million, which is a very awkward skewing of paper work versus value received. There are alternatives to the rebate requirement, and I will not spend a lot of time on those because, frankly, I do not think they work. We have the ability to purchase what are called "SLGS" State and Local Government Series Treasury Obligations, we can invest in tax-exempt securities, and we can invest in low-yielding taxable instruments. Let me just say that they are not practical. They do not work, and often they are limited by State regulation.

Let me sum up our comments about the rebate requirement by indicating that, although we think your bill is a tremendous step forward, we think that the related requirement ultimately must be repealed in its entirety. We think it is a confiscatory tax, and our former counsel, the former Attorney General of the United States, Griffin Bell, who was to represent us in a suit appealing our inter-

est on the tax bill has said several things that I would like to quote to you, which I think are sort of pithy and get to the point. "The earnings are not just taxed, they are taken. It is the only instance in tax law I know of where the government takes everything." I would like to give you a Glisson quote to add to that and say that I think it is procedurally obnoxious, given the fact, in particular, that many governments simply do not have the staff or the sophistication to deal with it. You have heard enough about arbitrage. Let me give just a few comments about the small issuer exception to the private business test, going from 10 percent back to 25 percent.

We think this promotes public/private cooperation and we think that it gives small issuers the needed flexibility to add certain commercial components to public projects, and we think it enhances the opportunity for public/private partnerships, and finally, we do not think it opens the floodgates to immense abuse. Let me demonstrate that by two Atlanta projects—it's close to home and I think it gets clearly at the issue.

I could give you a number of potential discussions of projects that might fit, but let me give you two that we have on the drawing board. One is in planning, and the other is almost complete. The first is a parking deck. We are in the process of completing an extension to our City Hall complex, and we need parking for that project. We would like to enhance the project by having amenities in the ground level that would be considered private, a cafeteria or some service oriented business, for example. So, in lieu of a structure that many of my colleagues have described as "a cage," we would have something in the South Central Business District that was attractive and served the needs of many people, in addition to simply being a parking structure. We can not do that under the current law and moreover, we will probably be restricted from operating it most efficiently. My preference is that we contract the operation for the parking deck as opposed to hiring governmental employees to perform that task. My suspicion is that we will be unable to do that as well because of the restrictions in the current law.

The second project is our Underground Atlanta Project. This is an accomplished fact which is nearing completion. The bond issue was sold at the last hour before the 1986 Tax Act took effect. Had it been in place, we would not have been able to revitalize a very important part of downtown Atlanta. If you were recently there, you will know that we have a lot of proclaiming going on about the revival of Underground, and we think it is critical to revitalizing what was truly a blighted area in the city, anchoring the South Central Business district. We would not have been able to do that project had the current rules been in effect. Rather than going to great length, if you have questions, I will be happy to extend my comments. I would also like to add that Ms. White, with the National Association of Bond Lawyers, will also suggest to you that the provisions you propose, at least as far as the two Atlanta projects that I mentioned, would probably not be sufficient to make those projects work because of further limitations in the law that restrict the private component to 5 percent, as opposed to 10 per-

cent. Rather than go into that, let me leave that as a yet to come issue, and she can go into it in great length.

Let me close by indicating that in addition to these two major components of the bill, we further strongly support the provision of technical assistance to local governments and your suggestion that a biennial report by the Secretary of Commerce on public works financing be forthcoming. Atlanta is a relatively large city. We can accommodate the bill. We do not particularly want to accommodate the tax law. I assure you that most of the cities and counties in this country are going to have an extremely difficult time dealing with the Tax Act without technical assistance.

Mr. Chairman, I have enjoyed the opportunity to speak before you and I hope that the more complete full testimony can be placed into the record.

Mr. SAVAGE. Without objection, so ordered.

Mr. GLISSON. I close simply by asking you, if you would, to convey my greetings to my Congressman, Mr. Lewis, who is not here today. He is unopposed, but he did have a primary in Georgia yesterday.

With that, thank you for your attention.

Mr. SAVAGE. Thank you, Mr. Glisson, and with the permission of the panel, we will withhold questions for Mr. Glisson until we hear Deputy Mayor Comer.

Mr. Comer, please proceed.

Mr. COMER. Mr. Chairman and members of the subcommittee, before I get into my testimony, I would just like to state that it is a particular pleasure being here with a committee that is Chaired by a neighbor. That is a particular pleasure. One of the other things mentioned was the clock. Being from the State of Indiana, which has the national basketball champions, I am accustomed to watching the clock, so I am going to work against that clock.

I am Richard Comer, Deputy Mayor of Gary, Indiana, and I am testifying on behalf of the National League of Cities.

Mr. SAVAGE. Excuse me, Mr. Comer, if I may interrupt for just a moment regarding the clock business. If you care to, what you could do is to summarize in the interest of time, and we will of course include your full testimony in the record as in the case of Mr. Glisson. Many of us have already had the pleasure of reading it because we received it in time.

Mr. COMER. Very good, let me then just pick out some things to share with you and this committee, some points in relation to what Pat has said. It is truly ironic that during this period of time that we have had to sharply curtail the issuance of municipal bonds the Federal Government has tripled the amount of bonds that it issues on an annual basis. And it most certainly has great effect on the operation of our cities. We are concerned about some of the points that Pat has made relating to arbitrage and also relating to that part of the law that deals with private activity and the exceptions that are involved at 10 percent use.

For the sake of time, let me just go to the last part of my prepared testimony and talk about the taxing of municipalities. The tax code truly is a model of confusion. For municipal officials, it has been a case of a double whammy as we have tried to adjust to

steep cuts in Federal assistance and to rising needs at the municipal level.

One of the most important benefits of this hearing and your effort is to shed light on an area of Federal policy that has, for too long, been hidden from the general public. Just as very few American families can purchase a family home with cash, almost no city can finance the construction of any school, waste-water facility, jail, street, or any other infrastructure facility with cash. We must finance these facilities with long term borrowing, with tax exempt bonds.

As the Federal Government has withdrawn from helping in many of these key areas of public investment, the importance of our capacity to finance by way of municipal bonds has increased. Yet, in this murky world, few have been able to follow the twists and turns of Federal tax changes and their impact over the past decade. Suffice it to say, these changes have cut from the back, even as we have been looking to the front.

In summarizing, your efforts today in holding this hearing, and supporting this legislation, are signs that Federal tax policy can no longer dominate Federal infrastructure policy. At the Treasury, they tell us their job is not to set public works policy, but rather to collect tax revenues. Unfortunately, in the past few years, that has not really been the case. It is just that federal public works policy has been largely conducted behind closed doors.

We are grateful for the light you are shining on the subject, and would be pleased to work with you in any way we can to restore sound Federal policy to this critical area of investment for our future. The cities truly need your help. Thank you very much.

Mr. SAVAGE. Thank you, Mr. Comer, and Mr. Glisson.

Let me begin the questioning by saying I thought that it was reported that our recent tax reforms were to simplify your record keeping problems and other problems with regard to revenue. Let me ask you then, to increase these percentages, does this not have the effect of encouraging your participation in the markets, and of your being able to extend the amount that you can invest of a bond issue? Would this not encourage cities to perhaps even gamble with regard to covering their own diminishing tax bases? Do you follow the question, either one of you?

Mr. GLISSON. Yes, sir, Mr. Chairman, let me respond by telling you that clearly there have been abuses or I don't think that we would have had a tax bill, and therefore I have to say that there are local governments in this country who have used the technique of selling low and investing high, purely to make an arbitrage profit if you will. That has happened. Let me tell you my strong personal belief, and certainly what I have worked for in that arena, and what I think most of my colleagues have worked for in that arena: that is not our motivation. Our motivation, and our needs are to finance roads, bridges, buildings, and fire stations. That is what we are in business to do. Clearly, there are those who have taken another path. I will tell you most of the time that we have taken that path, the few of us that have, it has been at the encouragement of, let me describe generically, "outside advisors," who tend to make a profit on that particular transaction. I don't think I am talking out of school to say that it would be my desire, that if it

is the intent of Congress to truly get at the issue, don't harm the cities, don't harm the taxpayers. Look at providers of financing debt: there are people who make money on that industry. We go to them to issue debt. They make money at it and often in the process encourage us to make pure arbitrage transactions. I assure you that is not our motivation, nor is it the predominate issuance of debt in this country.

Mr. SAVAGE. Doesn't this confront our concept of government, by that I mean that the purpose of tax exemption with regard to municipal bonding is to permit you to raise funds at a lower interest rate in order to not further burden your need for local revenue, right?

Mr. GLISSON. Right.

Mr. SAVAGE. If however, through extensions such as this, through what really amounts to trying to counteract the intent of the recent tax reform legislation adopted by this Congress, signed into law by its President—doesn't this increase further permit you to, rather than relying upon your traditional revenue sources, to really engage in what has traditionally been a private enterprise activity, participating in the market? Is that not, in effect, really, gambling, and an unexpected down-turn, as we experienced late last year, would then further burden your revenue sources? Does this not then damage or injure the integrity of local government in its budgeting, that is, the integrity required to set a cost which would include your bonding interest rates and so forth, and then turn to your constituents to raise that amount? This would permit you to gamble, not only involving, possibly, reducing the price to your constituency of your bonding and your projects, but also would carry with it the risk of increasing it, which puts you then into a kind of a private enterprise venture which is not traditional to government authority as we understand it historically in our system.

Mr. GLISSON. Mr. Chairman, if I understand your question and your point, I think the committee should understand that all governments would be obligated to repay the debt, and therefore not encouraged simply to gamble. Moreover, aside from what I think to be the motivation of local public officials, most of us are bound by fairly strict local laws that would prohibit sheer gambling in the market. Most of the issues in this country are local tax-exempt debt has been for pure infrastructure projects. You unfortunately, only hear about the more sexy, very limited number of transactions, wherein a government has, in fact, helped to finance something that was purely private.

Mr. SAVAGE. I'm going to ask that question next, you anticipated me, but no, what I was getting at with this point, however, was merely the matter of increasing the time and the percentages, and so forth, that you can use for investing when a public project may be up the road a bit. That is the only portion I'm asking at this point, but I intend to ask the other question later.

Mr. GLISSON. You mean, for instance issuing the bonds earlier than we actually need them?

Mr. SAVAGE. That precisely, and maybe even for an amount in excess of what you really need, in order to create a fund—not necessarily in order to, let's just say it happens, it occurs without in-

tention—but resulting in a fund that is then used in an arbitrage manner.

Mr. GLISSON. I will not tell you that this can not or does not happen. I will tell you that it is very minor in the grand scheme of public debt issuance in the country. As I mentioned earlier in my testimony, right now I sell bonds in today's market, 20 year debt, $8 million worth of debt, for 7.43 percent. There is nothing to assure me or the city of Atlanta that I could, in fact, receive an interest rate higher than that. In fact, if I went for a short term security, it would be less that 7.43 percent, probably 7.23 or 25 percent. So, most governments and their finance officers are not going to take the imprudent step of, in fact, gambling on the market.

Mr. SAVAGE. Well, of course, H.R. 3807 does not apply only to Atlanta, so that your particular restrictions would not govern our position with regard to H.R. 3807. But what I think is that you recognize there has been some abuse, you are saying that such abuse has been minimal. and I gather that you do not condone it, however minimal, but you just point that out to say that it is not a major problem. In light of that reasoning, does not H.R. 3807, and I gather that you support its provisions, form the basis, or permit, if not encourage, increasing of even this minimal abuse that you recognize now exists?

Mr. GLISSON. Mr. Chairman, I really do not think so, because as I mentioned before, there were already prior to arbitrage limitations, that is, we were required to spend the money within three years. I think, in addition to what I've said previously, you run the risk by issuing early and then coming into the three year limitation. Public projects simply do not happen in a short period of time, and therefore, from beginning to end, from preparation of bids, analyzing awards, weather constraints, and everything that could occur, I think you run the risk of meeting what were in place as arbitrage restrictions even before the new tax act. Therefore, I think one would be imprudent to run the risk of simply using the money for some period of time to gain interest, rather than immediately working toward completing the project.

Mr. SAVAGE. Mr. Comer, one final question, if I may, about the matter of bonding for private purposes or non-governmental purposes. I can appreciate the need, particularly with cities that are negatively impacted by structural changes in our economy such as Gary, to find additional ways to encourage the development of new business. However, when the tax-exempt feature of municipal bonding is used for that purpose, since that is permitted for all cities throughout this Nation, could not then the effect of it be canceled with regard to the encouragement by a particular city as a consequence of competition between cities using this method, and would it not then have a negative effect on the tax revenues of the Federal Government? That is, you would be using tax-exempt bonding authority to reduce what would really be paid in interest rates normally by new or developing private business. They would have to go elsewhere to get their assistance. Maybe they would not because of the attractiveness of tax-exempt bonding, but is not the attractiveness neutralized by the fact that all cities would have the same privilege, and that, therefore, the overall effect would simply be negative with regard to our economy?

Mr. COMER. We have real concerns about the definition of private activity, if there is a 10 percent or more use by the private sector, that becomes what would be defined as private activity.

In other words, if our city owns and operates a facility—say a courthouse, but leases one floor for a day care center, our courthouse would be defined as a private activity. That, I submit, is absurd.

Now in the bonding process, you start to have to pay for the risk that is taken by the institutions when you are trying to sell those bonds, because of their wondering whether they will fall into a private activity definition. To show you just how dangerous that could be, if we are talking about dealing with the infrastructure of our roads, or more specifically, our sanitary district, where there is a user fee and you are dealing with your constituents, your tax paying citizens and also some of your large private corporations. If it were so determined that the volume used by the private sector was more than 10 percent of the operation of the district, you could be at risk in terms of being labeled "private activity," which would cause you to pay higher interest on your bonding.

With regard to your concern about so-called small industrial development bonds, the authority to issue by municipalities was eliminated in the 1986 act, except for manufacturing purposes. That authority is scheduled to expire next year.

NLC's position has always been that such bonds should be targeted to areas of distress.

Mr. SAVAGE. Excuse me, Mr. Comer, but H.R. 3807 is proposing to increase that 10 percent to 25 percent, right?

Mr. COMER. Yes, 10 percent to 25 percent.

Mr. SAVAGE. Yes.

Mr. McEwen.

Mr. MCEWEN. I would yield first to the author of the bill, and the prime author of the Economic Development Act seven years ago and a long-time member of our committee, and then I will reserve my questions until after Mr. Clinger, if I may.

Mr. SAVAGE. Mr. Clinger?

Mr. CLINGER. Thank you very much, Mr. McEwen and Mr. Chairman.

Gentlemen, we thank you very much for your testimony. We particularly thank you for your support for this initiative which I would agree with you is not an entire answer, but I think it represents a good first step toward reversing what was a very unfortunate decision in my view, by the Ways and Means Committee. As I said in my opening statement, what we have is a double whammy. You had been impacted over recent years because of budgetary constraints by cutbacks in almost all of the Federal infrastructure programs, whether it's sewage treatment, highways, any number of areas had been reduced. At the same time, we have asked you to assume a greater part of that burden to become more involved in and responsible for the financing of needed infrastructure projects, while at the same time we were cutting back on the resources. The Federal Government was also taking away the incentives and the things that made it possible for you to go into the bond market and function effectively. So, I think that what we have tried to do in this effort, which Chairman Howard was intimately involved in,

was to ease that tension and to restore to you, at least partially, some incentives to get into the bond market to finance these things without doing grievous harm to your municipalities, and I think that this is what this would do. In terms of this private interest—it says that before the Tax Reform Act it was at 25 percent, correct?

Mr. GLISSON. Correct.

Mr. CLINGER. In your sense, what kind of abuses were they trying to address, or was this really not so much a question of abuse as it was purely a revenue raising measure?

Mr. GLISSON. Let me begin by saying that I am not certain that there was sufficient data to even indicate that there were abuses to begin with, such as they were. I think if you compare, for instance, the Underground project that I mentioned, which is a public/private partnership, one that I assume that most of those thinking at the national level would encourage, most of the attention was probably focused on areas that were in the IDB sector, which never got translated into the differentiation between a governmental bond that happened to have some private participation I'd hasten to add, and I think this gets partially at the Chairman's question, that basic private-purpose IDB's are sold for such purposes for manufacturing facilities. We have, as an association, and the NLC has taken a similar position supporting restriction on these types of tax-exempt-bonds.

Mr. CLINGER. Let me interrupt right there because I think that is a very critical point. As you have indicated, probably the abuses were primarily in the IDB area, and we have now put very real restrictions on the use of IDB's, the abuses such as massage parlors, and motels, and so forth being funded out of these things. Really we have corrected that abuse through other parts of the tax law, and this is kind of an over-kill, wouldn't you agree with that?

Mr. GLISSON. That's my view, Congressman. I think that there was never a clean translation between what was happening in the different sectors. In the IDB area, our organizations have always taken the position that, private purpose conduit IDB's ought to be targeted. Say with UDAG-type restrictions on economically impoverished areas as opposed to anywhere, as you mentioned for massage parlor, or redoing a legal office, or building a McDonalds, or any number of things that hit the press. The fact of the matter is, I think the attention was in the IDB area not where we were trying to do legitimate public projects that happened to have some small private component, one that made the project work well and served the community.

Mr. CLINGER. Thank you.

Mr. Comer, I want to turn your attention to something that just came to our attention, where you cite the tax bill recently passed by the House, that is the "Technical Corrections Bill," and note that the July 15, 1988 date contained in the legislation is hindering the ability of local governments to bring new issues to market. I am curious as to why a bill not yet enacted into law can have such a major impact. It is not presently in law, but it is contemplated that after it goes through the conference process that it could be, but it is not in law now. How does that impact you?

Mr. COMER. It puts a little cloud on your operation in that things you do beyond the July date—you are caught in a kind of Catch 22 situation.

Mr. CLINGER. In effect, when a bond council is not prepared to certify, based on what may or may not become law, but at least as long as it is there it is going to really impact upon you very harmfully.

Mr. COMER. Absolutely.

Mr. CLINGER. The Tax Reform Act passed two years ago, and I am amazed to hear—I guess I knew this—but the regulations have not yet been fully promulgated to allow you to even know how to proceed in these areas, is that correct?

Mr. GLISSON. That is correct. We are amazed at it as well. We are flying by what we anticipate will be the regulations, but they are, as we speak, not promising.

Mr. CLINGER. Do you have any indication from IRS or from Treasury as to when they propose to promulgate these regulations?

Mr. GLISSON. I am told by my expert that we anticipate, or our staff has been told, first set in December, and perhaps the second set, sometime in January.

Mr. CLINGER. So, a good two years after the bill became law.

Mr. Comer, the National League of Cities is one that we recognize in this committee as one of the preeminent associations representing local governments, and as one that has been a very valued witness before this committee over the years. At the time the House Ways and Means and Senate Finance Committees were drafting the 1986 Act, were you or any of the members of the National League of Cities consulted regarding the changes in bond regulations that were put into this law?

Mr. COMER. If I might defer to one of our experts here on that answer.

Mr. CLINGER. It was my understanding, Mr. Comer, that the National League was actually asked to leave the room when this whole matter was discussed.

Mr. COMER. That is what I have just been told. We had asked to testify.

Mr. CLINGER. I think that the result clearly reflects that.

Thank you very much, gentlemen.

Mr. SAVAGE. Let me remind you of the bells and the lights on the clock—we are going to recess in order to run over to vote.

Let me say that our ranking member, Mr. McEwen, indicated that he has no questions, and if you don't have questions, Mr. Payne, we could dismiss this panel while we go to vote, and then when we return we would resume without taking a break for lunch, if everyone is in agreement?

Let me then thank you very much, Mr. Glisson and Mr. Comer, for your understanding of the problems of the bells, and when we return from voting in about ten minutes, we will call upon Ms. Sharon White, Past President of the National Association of Bond Lawyers.

Thank you.

[The prepared statements of Mr. Glisson and Mr. Comer follow:]

Testimony

of

Patrick C. Glisson
Commissioner of Finance
City of Atlanta, Georgia

and

Acting President
Government Finance Officers Association

before the

Subcommittee on Economic Development
Committee on Public Works and Transportation
U.S. House of Representatives

August 10, 1988

Room 2165
Rayburn House Office Building

89-890 0 - 88 - 2

INTRODUCTION

Good morning Mr. Chairman. My name is Patrick C. Glisson. I am the Commissioner of Finance for the City of Atlanta, Georgia and I am here representing the Government Finance Officers Association (GFOA) as its Acting President. The Association's membership consists of 11,000 state and local officials and other professionals who issue the tax-exempt bonds to finance public works projects, prepare operating and capital budgets, manage public funds and keep the financial records of cities, towns, counties, states and special districts. Thank you for your invitation to appear before the subcommittee.

If anyone understands the true problems and hardships created by the 1986 Tax Reform Act for public works financing it is state and local finance officials. That law, which was aimed at curbing abusive tax-exempt transactions and reducing the volume of so-called private activity bonds, went well beyond its intended purposes and disrupted tax-exempt financing for the most basic governmental purposes.

The Government Finance Officers Association supports H.R. 3807 because it provides relief from provisions in the Tax Reform Act that greatly complicate the financing of public works facilities and raises the cost of financing these projects significantly. H.R. 3807 will provide relief for a large number of governments at a low cost to the federal government because of an interesting and important aspect of the tax-exempt market. The municipal bond market is characterized by a great diversity in the size of issues and a highly skewed distribution. In other words, a relatively few large issuers account for the bulk of the dollars borrowed. As a result, a large number of small issuers can benefit from a change without having a significant impact on the total dollar volume.

Let me take a few minutes to explain some of the problems with the 1986 Tax Reform Act and why the legislation before us today is so beneficial.

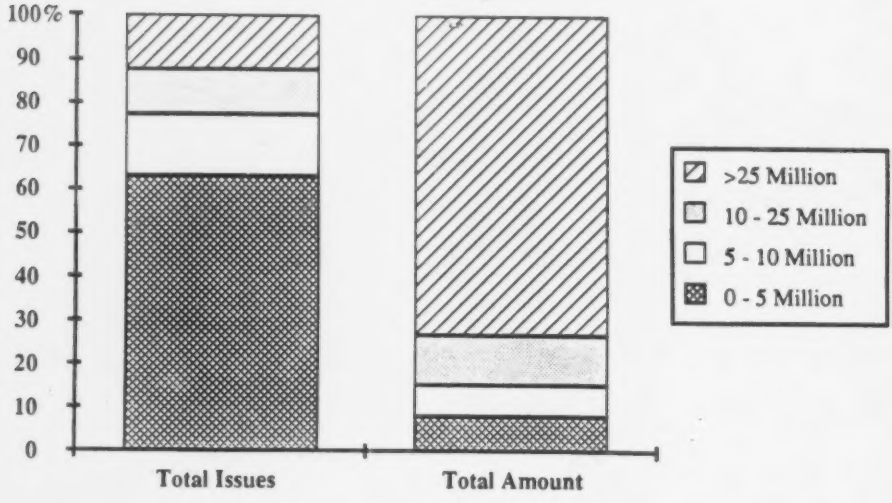
For more information contact Patrick C. Glisson, Commissioner of Finance, City of Atlanta, 601 City Hall, Atlanta, Georgia 30335 (404) 658-6480 or Catherine L. Spain, Director, Federal Liaison Center, Government Finance Officers Association, 1750 K Street, N.W., Suite 200, Washington, D.C. 20006 (202) 429-2750.

MODIFICATION OF THE ARBITRAGE REBATE EXEMPTION

The proposal to extend the exemption from the arbitrage rebate to apply to government units that issue $25 million or less of tax-exempt bonds annually, instead of the present law $5 million, reduces the tremendous arbitrage rebate compliance burdens for many small governments.

As can be seen in the graph below, in 1987, small municipal bond issues in amounts less than $5 million represented 63.04 percent of the total number of issues sold, but only 8.26 percent of the total dollar amount of bonds sold. There were 5,260 of these small issues. By raising the limit on the arbitrage rebate exemption to $25 million, 2,064 additional issues are potentially eligible for the exemption, representing 87.75 percent of the total issues, but at most 26.65 percent of the total bond volume. This percentage is slightly overstated because it includes small private-activity financings which are not affected by the bill.

Total 1987 Municipal Debt Issuances
Percentage Distribution by Issue Size
Total Number of Issues and Total Amount Issued



How the Arbitrage Rebate Requirement Works

Without burdening you with the enormously complex details of the arbitrage rebate requirement, let me explain how the new restriction works. Let's assume Atlanta sells bonds for a public works project and pays an interest rate of 7.0 percent to borrow the money. Because the interest income from the bonds is generally tax-exempt from federal income taxation, the bond purchasers are willing to accept a lower interest rate. The bond proceeds that are received by the finance department are invested in higher yielding securities in order to earn investment income until the monies are needed to pay contractors. This practice is a prudent financial management technique.

In the perfect world envisioned by the writers of the 1986 arbitrage rebate requirement, all bond proceeds would be spent six months after the bonds are sold. By law, if that fails to happen, then the issuer is presumed to have sold the debt too early and the bonds are subject to the arbitrage rebate requirement. In essence the requirement provides that "excess" arbitrage, which is defined as interest income earned from the investment of the proceeds that is attributable to the difference between the tax-exempt borrowing rate and the higher reinvestment rate, must be paid -- or rebated -- to the federal government.

The purpose of the arbitrage rebate is to remove any incentive to issue bonds for projects that may never come to fruition, to issue them earlier than needed and to leave them outstanding longer than they otherwise would. The objective is to reduce the amount of bonds that are purchased by taxpayers who are able to exclude the interest income from federal income taxation.

Unfortunately, ours is not a perfect world and it is virtually impossible to spend bond proceeds within a six month time frame. I am sure most other issuers encounter similar problems, and, as you will see, the delays are legitimate, not motivated by arbitrage earnings. The Atlanta City Charter requires funds to be "in place" before a City department enters into a contract. The contracting process involves multiple steps which result in several months elapsing before a contract can be signed. Bids must be prepared, advertised, and analyzed after the receipt of the bond proceeds. Once a contractor is chosen, the contract compliance office has to review the contract to determine that the City minority participation requirement is satisfied. Other delays due to litigation, inclement weather, and labor disputes are always possible causes for delay. Furthermore, large public works projects cannot be built in a short period of time and prepayment on a building

contract would not be fiscally sound and is not permitted under the arbitrage rebate provision in federal law.

Under prior law governing the earning of arbitrage, state and local government issuers had a three-year "temporary period" to spend their bond proceeds and reinvest unused proceeds without any earnings limitations. However, other restrictions did apply. This three-year "grace" period provided adequate time to spend the bond proceeds and permitted issuers to earn interest income that could be used to reduce project costs. For you see, when public borrowings are sized, the finance office determines how much a project will cost, estimates how much arbitrage (investment income) will be earned, and then reduces the total amount to be borrowed by the amount of the interest income that is expected to be earned. The Government Finance Officers Association's Research Center has estimated that the amount of tax-exempt borrowing for a project financed with bonds paying seven percent and reinvested in securities paying nine percent would increase by 10 to 12 percent because of the loss of investment income. This means that 10 to 12 percent more tax-exempt bonds must be sold. (The estimate assumes that one-third of the bond proceeds is spent during each year of the three-year temporary period.)

Steps in the Arbitrage Rebate Compliance Process

Although the rebate requirement seems relatively straightforward, it mandates significant changes to government issuers' cash management and accounting functions. The compliance process may be broken down into three basic steps which are described below:

1) calculating the arbitrage earnings limit,

2) monitoring the investment and expenditure of bond proceeds, and

3) rebating excess earnings to the U.S. Treasury.

The calculation of the arbitrage earnings limit is the initial step in the compliance process. It involves determining what the bond yield is so the jurisdiction can calculate how much arbitrage can be earned legally. This calculation may be performed by the issuing jurisdiction's staff, though it will require the issuer to develop or purchase software for the calculation, or the jurisdiction may pay its bond counsel, financial advisor, underwriter or some other consultant to perform the calculation. While there were earnings limitations before 1986 that applied after the three-year temporary period, issuers could always reasonably expect that all bond proceeds from a bond sale

would be spent before three years. Therefore, it was not necessary to closely monitor the earnings limitations.

Monitoring - the investment and expenditure of bond proceeds creates substantial burdens for issuers and requires public officials to change their accounting and investment practices, oftentimes abandoning what are considered best practices. Atlanta's approach to investment of funds is sophisticated and fiscally sound. Monies from 20 or more fund groups are blended into an account called the "concentration account" in order to simplify the investment process. Funds for such widely varying purposes as airports, and water and sewer projects are placed in this pooled account. This approach has several advantages. The City is able to enjoy the benefits that are associated with large-block trading, such as lower brokerage fees. Additionally, there is a relatively simple reporting system in place, since overall fund earnings are reported to the accounting staff by the investment officer and the accountants, in turn, allocate what is earned to each individual fund based on the fund's average daily balance.

In order to monitor investments to comply with the arbitrage rebate requirement, proceeds of each bond issue subject to the new arbitrage rebate must be invested separately and not pooled with the concentration account. Atlanta's active approach to fund investments results in hundreds of investments per fund per year. Herein lies the main difficulties in monitoring the city's arbitrage earnings. First, given an investment portfolio purchased with funds from many different sources, it will be difficult to determine the earnings yield for any given portion of the total fund. Second, given the potential for a large number of investment transactions, the reporting requirements for determining the yield amounts would be monumental. For each bond issued after the 1986 Tax Reform Act's effective date, the investment earnings have to be calculated separately. This requires a large amount of additional paperwork and an overhaul of the existing computer system.

The investment monitoring problem is further complicated by the fact that excess tax receipts in a debt service fund are defined as bond proceeds and subjected to the rebate requirement unless the earnings are less than $100,000. The City must now monitor these funds containing tax monies for arbitrage purposes. Debt service funds are established to accumulate annual principal and interest payments for bond issues.

The second function to be affected by the rebate's imposition is the accounting function of the City. The accounting bureau is responsible for (1) maintaining the

accounting records relating to the expenditure of bond proceeds and tax receipts earmarked to pay the annual debt service on the bonds, (2) reporting the results of investment returns and (3) determining the amount of rebate to the federal government.

For each bond issue sold after the effective date of the 1986 Tax Reform Act, two new funds will have to be created--a construction fund and a debt service fund both with separate arbitrage rebate accounts. Initially, bond proceeds will flow into the appropriate construction fund. Interest earnings from this fund will flow back into it, with the exception of "excess" arbitrage earnings, which will flow into the arbitrage rebate account. As tax receipts are received which will be used to pay off the bonds, they will be placed into the debt service account. Interest earnings from the debt service account will flow back to the debt service account, with the exception of excess arbitrage earnings, which will flow into the arbitrage rebate account.

When accounting for funds spent for a particular project, the City must determine from which specific bond issue expended funds originated. The accounting bureau will also have to wade through many reports on investment activities in order to properly determine individual account balances. For the purpose of the annual financial report, these accounts will have to be consolidated in order to conform to generally accepted accounting principles. Simultaneously, the City must disaggregate the accounts in order to determine arbitrage earnings and possible rebates owed to the Treasury every five years.

Recently the City's accounting bureau completed the consolidation of many of its account groups. The requirements of the new tax law have forced the City to undo what it has spent considerable time and money to accomplish in order to streamline and modernize its financial management practices. The City's accounting bureau has adopted a system of double bookkeeping in order to comply with the arbitrage requirement. One set will be essentially the same as existed prior to the enactment of the 1986 law. The second set will be significantly more complex than the first. This represents a major departure from the pre-tax reform operations of the City.

Finally, let me address the third phase of compliance: the rebate calculation. The City does not currently have the facilities in place in the form of computer software to perform the rebate calculation in-house and a consultant has not been retained. Even if the City purchases software or hires a consultant, there will be requirements to collect the data needed to perform the calculation. The City anticipates

having to employ at least one additional staff person. To have the calculation performed by a consultant, the City would expect to pay $2,500 per issue each year there is debt outstanding. Every year Atlanta sells an $8 million general obligation bond that has an average 20-year maturity. Therefore, at least $50,000 in additional costs ($2,500 x 20 years) would be incurred to perform the rebate calculation--even if a rebate is not owed. Over the next 10 years, this would add up to one-half million dollars in additional compliance costs for Atlanta's general obligation issues. This estimate does not include the expenses for airport, water and sewer, development authority or other special-purpose revenue bond issues.

It is important to reinforce the fact that a city must undertake all of these new procedures whether or not an arbitrage rebate is ever owed because there is no way to determine in advance whether or not a rebate will be required.

The GFOA has estimated that arbitrage rebate compliance costs for state and local issuers could exceed $1.1 billion in the first five years. We estimate that the projected revenues from the arbitrage rebate are at most $150 million for the same period based on Joint Tax Committee estimates. Therefore, the federal revenue impact of the change in the exemption limit proposed in H.R. 3807 should not be very great given the small percentage of bond volume affected.

Alternatives to the Arbitrage Rebate Requirement

In enacting the arbitrage rebate requirement the Congress recognized that administrative burdens were being imposed. To limit the burdens several actions were taken in addition to providing the $5.0 million rebate exception. One was to require the Treasury Department to improve its State and Local Government Series (SLGs) program. This program makes Treasury securities available for purchase by state and local governments, using bond proceeds that are subject to the arbitrage rebate requirement. By investing in these Treasury securities, governments are assured no excess arbitrage is earned so they are freed from the investment monitoring and the tracking of bond investments and expenditures. Another safe harbor provided in the legislation is investments in other tax-exempt securities.

While alternatives to the rebate exist they are not viable alternatives. For example, in Georgia there is a state law governing local cash management practices which limits the investment of local funds in tax-exempt securities to those offered by the State of Georgia and its instrumentalities. Since the amount of short-term securities

that would be appropriate for this type of investment is far outstripped by the potential demand of the cities and other local borrowers in the State of Georgia, investing in tax-exempt securities is not a practical option. The SLGs program has not been used by the City in the past and even with mandated improvements it is not being used because an adequate rate of return is not provided.

A third option for the City is to invest in taxable securities that pay a lower yield than that paid on the tax-exempt bond. This option is avoided because it is thought to violate fiduciary standards. State and local investment officials are expected to maximize investment returns to the extent possible.

Overall Objections to the Arbitrage Rebate Requirement

Our Association views the rebate as a direct tax on state and local government investment earnings and we oppose it across the board. Former U.S. Attorney General Griffin B. Bell has called the rebate a confiscatory tax saying that "The earnings are not just taxed, they are taken." He also said that, "It is the only instance in tax law I know of where the government takes everything." I believe it is procedurally obnoxious particularly given limited resources and often limited sophistication at the local level.

The Joint Committee on Taxation (JCT) explanation of the rebate states that "arbitrage transactions have no economic substance, but are made profitable solely through the ability to borrow at tax-exempt rates." (See JCT, General Explanation of the Tax Reform Act of 1986 -- the "Blue Book" -- May 4, 1987, pp. 1154-1155.) This is only true in those instances where tax-exempt debt is issued for the sole or primary purpose of making an arbitrage profit. Our organization does not condone such arbitrage-motivated transactions, but the imposition of the rebate was an overkill reaction. We believe that a more rational and less onerous solution could have been found whereby the Treasury Department used its authority and took regulatory action or the Congress targeted its new restrictions to the perceived abuses.

The Government Finance Officers Association strongly supports the relief provided to governmental issuers by H.R. 3807 because it

- eliminates a confiscatory tax on over two thousand additional issuers,
- provides relief from the administrative burdens and costs associated with the rebate, and

- permits issuers to earn investment income and reduce the amount of tax-exempt debt that must be sold for a capital project.

In an effort to curtail known abuses and every potential abusive situation, the arbitrage rebate law has been written to deal with the small percentage of flagrant violators rather than for the benefit of the vast majority of issuers trying to comply honestly and fully. State and local officials have supported Congressional and Treasury efforts over the years to prevent transactions undertaken solely for the purpose of earning an arbitrage profit. Unfortunately, the system of regulation has steadily grown to be overly complex. It is so complicated that few state and local officials are able to take the time to master all of the details. We believe it is fair to say that members of the tax-writing committees did not fully understand the level of complexity they were adding to the debt issuance process and the cost burdens that were being imposed on issuers. In enacting the rebate the Congress went beyond the laudable policy objectives of prohibiting abusive transactions and preventing the overissuance of debt. Accordingly, we support H.R. 3807 as a significant improvement and believe that ultimately the rebate requirement must be repealed.

PROPOSED SMALL-ISSUER EXCEPTION FOR PRIVATE BUSINESS TESTS

The proposed change to allow eligible small governmental issuers to use up to 25 percent of their bond proceeds for nongovernmental uses will give small issuers flexibility to add commercial and other facilities to publicly financed projects and enhance the opportunities for public-private cooperation in the provision of services. This change does not open the floodgates for billions of dollars of new private-purpose financings.

In 1986 several changes were made in the tax code rules that permit tax-exempt financing for private beneficiaries. These changes included eliminating certain activities from the list of private-activity bonds that are eligible for tax-exempt financing and changing the legal definition of a governmental bond. This latter change involved reducing the percentage of governmental bond proceeds that could be used in a trade or business by a private party from 25 percent to 10 percent. The same change was made with respect to the amount of payment of principal or interest which could be derived from or secured by money or property used in a trade or business. Both of these limits or "tests" must be exceeded or "passed" before a bond is categorized as a private-activity bond. The first test is known as the trade or business test; the second is the security interest test.

It is often necessary or desirable for a city or other political subdivision in the exercise of its truly public functions to allocate the use of a portion of a public facility to someone for use in a trade or business. Some examples are

- o the leasing of a newsstand in a public building, and
- o the contracting of a cafeteria service in a public school or government building to a private enterprise.

The best way to describe how the proposed definitional change in H.R. 3807 would be beneficial is to describe two projects in Atlanta that involve public-private partnerships and how the changes could have affected the projects. The first involves a parking garage that is being planned in connection with our City Hall renovations.

In order to improve the appearance of the new parking facility and make it more functional, the City would like the option of adding commercial space so that a restaurant or some other service could be added. Public buildings may be designed in recognition of the fact that the space on the ground level is of more economic value for commercial purposes than for the purpose for which the governmental building is built. Therefore a somewhat larger building than is needed for the governmental purposes of the owner may be constructed so that commercial space on the ground floor is available for rent.

Given the current law, we are unfortunately unable to enhance the complex and make services available to the workers in the section of the city surrounding City Hall... and may be limited in operating it most efficiently. The present requirements even limit our ability to contract out to private enterprise.

A second example is the restoration of Underground Atlanta. The City of Atlanta and its Downtown Development Authority joined forces to redevelop the blighted area known as Underground Atlanta and replace it with walkways and public access areas as well as economically viable structures such as shops and restaurants. These festival marketplace "private" amenities were intended to complement the public areas. The portion of the redevelopment cost paid by the Atlanta Downtown Development Authority, which is a separate public entity established by the City, was obtained through the issuance of bonds which were backed up by a lease with the City of Atlanta. The City obtained a ruling from the U.S. Treasury Department prior to the 1986 Act went into

effect that the bonds were not private-activity bonds because less than 25 percent of the proceeds would be used for facilities that were used in the trade or business of a private enterprise. Had this project been subjected to the present law 10 percent test, it would not have been doable because the private-use component would have been excessive and historic Underground Atlanta would not be well on its way to revitalization.

It is important to note that your bill does not modify a portion of the security interest test that the tax bill drafters were adamant about changing and where they felt the law was too lenient. The claim was made that governmental bond issues were structured intentionally to "fail" the prior-law security interest test and retain their classification as governmental bonds. (See JCT, "Blue Book," p. 1152) The 1986 law provides that the security interest test is satisfied when payments are formally pledged as security for payment and also when any underlying arrangement is provided for such payments. This second criterion is new and unaltered by H.R. 3807.

The Joint Committee on Taxation "Blue Book" also states that Congress was concerned that, under prior law, a significant amount of bond proceeds from governmental issues were being used to finance private activities not specifically authorized to receive tax-exempt financing (See page 1152). It should be noted that no data were uniformly collected on the thousands of governmental debt issuances so it is difficult to determine the basis for this conclusion.

If I were to make one recommendation, it would be to extend the definitional change to all governmental issues so that large and small issuers could leverage private investment with public funds. Atlanta will most likely not be able to meet the definition of small governmental issuer in the bill.

OTHER PROVISIONS IN H.R. 3807

The Government Finance Officers Association also supports the provisions in the bill providing for technical assistance and a biennial report by the Secretary of Commerce on public works financing.

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STATEMENT OF

RICHARD J. COMER, DEPUTY MAYOR

GARY, INDIANA

on behalf of

THE NATIONAL LEAGUE OF CITIES

AUGUST 10, 1988

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STATEMENT OF

RICHARD J. COMER

DEPUTY MAYOR

GARY, INDIANA

ON BEHALF OF

THE NATIONAL LEAGUE OF CITIES

AUGUST 10, 1988

Mr. Chairman and members of the subcommittee, I am Richard Comer, Deputy Mayor of Gary, Indiana. I am testifying on behalf of NLC and the 16,000 cities and towns we represent in support of H.R. 3807 and how it will enhance local governments' ability to finance and maintain our local public infrastructure investment.

We commend this committee for its leadership in recognizing the transportation and infrastructure needs of local governments and taking steps to correct some of our concerns. Last year we testified before another subcommittee of this committee on the difficulties in financing local public works projects due to recent changes in federal tax laws.

These changes have occurred at the same time that the federal government is abandoning it partnership with local governments. Current federal fiscal policies have diminished the ability of cities to pay and plan for infrastructure needs and to direct industrial growth.

H.R. 3807 would help correct problems caused by tax code changes which discourage, tax, or penalize public capital investments in the nation's infrastructure. These changes are necessary due to the negative impact of the 1986 Tax Reform Act in local governments.

Changes in the Tax Laws

While the 1986 tax law was supposed to simplify the federal tax code, it has done exactly the opposite for the nation's cities and towns. Nearly two years after the new law's retroactive date of initiation, the Treasury still has not issued any of the key regulations for municipal debt issuance. Footnotes in the "Blue Book" which go well beyond the new law itself have further added to uncertainty.

Moreover, even while we wait in the twilight zone for implementation of the 1986 law, we are confronted with a retroactive provision adversely affecting infrastructure in the tax bill passed by the House last week. That provision has an effective date of July 15, 1988, which means that bond counsels can not give a legal opinion on any bond issue which does not meet the proposed change. This has already affected the Ohio program to provide low interest loans to cities and towns for water infrastructure financing, and we anticipate it will impact every state and municipal revolving loan program throughout the nation - certainly every one set up to comply with the new Clean Water Act.

All these changes, coming on top of federal tax law changes affecting our authority and ability to issue municipal bonds in the 1982 and 1984 laws, have sharply reduced the volume of bonds cities and towns have been able to issue. But at the same time, these changes have greatly increased the cost of these bonds to our taxpayers. As a result, local taxpayers must today pay more for building and repairing schools, more for jails, more for streets, and more for other public infrastructure facilities - without getting anything more for their taxes.

It is ironic that during this same period when we have had to sharply curtail the issuance of municipal bonds, the federal government has tripled the amount of bonds it issues on an annual basis.

The definitional changes on what constitutes a municipal "governmental purpose", the restrictions on arbitrage earnings -- including municipal property and income taxes used in a reserve or sinking fund -- the alternative minimum tax, and the rebate provisions have had the greatest impacts.

In our 1987 fiscal survey, 80 percent of our respondents identified restoring full tax exemption as very important, and 65 percent identified restoring the old arbitrage provisions. Nearly 75 percent have altered their capital and debt policies. Such changes are in a legal "twilight zone," however, awaiting regulations from the IRS.

In our just completed 1988 fiscal survey, 44 percent of our respondents reported they had cut capital or infrastructure expenditures during the last year. This number is consistent with reduced bond volume and the termination of the General Revenue Sharing program. But is comes at a time when federal public infrastructure investment is declining, and, given the Gramm-Rudman targets, almost certain to continue to decline.

Certainly, we believe that the committee's efforts are critical if municipalities are to be able to keep up investment in our future.

10% rule

The committee bill would return municipal issuers of less than $25 million a year to the pre-1986 definition of what constitutes a traditional public purpose bond. At a time when more and more cities are considering public-private partnerships, privatization, and impact fees to help finance public infrastructure, this is a provision we strongly support.

Most of our members have had to change their debt policies to determine whether they may comply with the new 10 percent rule. In our 1988 fiscal survey, 43 percent have either taken action or have pending proposals to comply with the 10% rule.

While we know that not a single municipally owned and operated airport in the nation is defined under the new law a "governmental purpose" facility, we are finding an increasing number of municipal wastewater treatment plants, streets, and other capital facilities which similarly fail the test. We are awaiting important IRS letter rulings with regard to a highway extension in Oregon and hazardous waste clean-ups in New York.

Under a strict interpretation, suggested by a staff member of the Joint Tax Committee, if more than 10% of the vehicles using a segment of public highway were employees or customers of a development, factory, or business - then the bonds issued to finance that segment would be defined as "private activity" bonds.

Similarly, the IRS might determine that if New York were able to recover clean up funds from private parties, or the waste sites the state used were on private propoerty, then the activities would be defined as "private activities."

arbitrage and rebate

Our survey has already found that virtually all cities have experienced a significant increase in administrative costs and paperwork to comply with the new law. This has both reduced the ability to issue and reduced the amount of capital actually available for public investment. We anticipate that if and when the Treasury issues new arbitrage and rebate regulations, our costs of compliance will escalate significantly.

For that reason, we strongly support the repeal of the arbitrage and rebate provisions as they apply to smaller municipalities, and we believe your efforts were helpful in persuading the Ways and Means Committee to incorporate an amendment in the Technical Corrections bill to instruct the Treasury to make the arbitrage and rebate rules more understandable, flexible, and workable for all cities.

thresholds

The committee's approach is directed towards municipalities which issue less than $25 million annually in traditional public purpose bonds.

To give you some idea of the impact, we asked our members in our 1988 fiscal survey:

We found that the following sizes of cities issued more than $10 million last year:

* 4% of cities with a population under 50,000;
* 12% of cities with a population up to 100,000;
* 26% of cities with a population up to 300,000; and
* 51% of cities with a population over 300,000 would be

Using the $25 million level, we found that the following exceeded that level last year:

* 1% of cities with a population under 50,000;
* 1.5% of cities with a population up to 100,000;
* 11% of cities with a population up to 300,000; and
* 25% of cities with a population in excess of 300,000.

It is clear that increasing the threshold from the current level to $25 million annually would have a major benefit for most cities, counties, and towns in the country.

taxing municipalities

The tax code is a model of confusion. For municipal officials, it has been a case of a double whammy, as we have tried to adjust to steep cuts in federal assistance and rising needs at the municipal level.

One of the most important benefits of this hearing and your effort is to shed some light on an area of federal policy that has, for too long, been hidden from the general public.

Just as very few American families can purchase a family home with cash, almost no city can finance the construction of any school, wastewater facility, jail, street, or any other infrastructure facility with cash. We must finance these facilities with long term borrowing - with tax exempt bonds.

As the federal government has withdrawn from helping in many of these key areas of public investment, the importance of our capacity to finance with municipal bonds has increased. Yet, in this murky world, few have been able to follow the twists and turns of federal tax changes and their impact over the past decade.

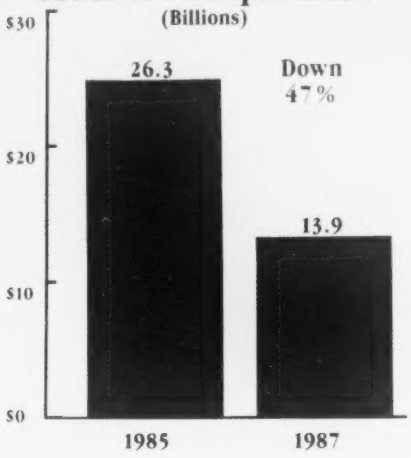
Suffice it to say, these changes have cut from the back, even as we have been looking to the front.

Your efforts today in holding this hearing, in supporting this legislation, are signs that federal tax policy can no longer dominate federal infrastructure policy. At the Treasury, they tell us their job is not to set public works policy, but rather to collect tax revenues. Unfortunately, in the past few years, that has not really been the case. It is just that federal public works policy has been largely conducted behind closed doors at the IRS and Congress' tax committees.

We are grateful for the light you are shining on the subject, and would be pleased to work with you in any way we can to restore sound federal policy to this critical area of investment for our future.

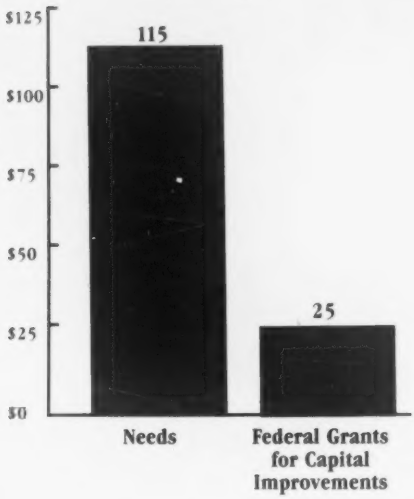
State and Local Bonds Issued for Water, Sewer & Transportation

(Billions)



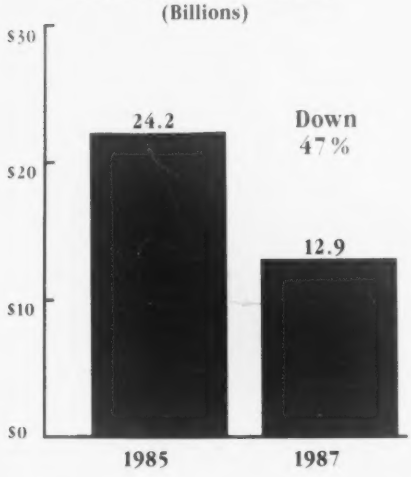
National Needs for Water, Sewer & Transportation

(Billions)



State and Local Bonds Issued for Schools

(Billions)



National Needs for Schools

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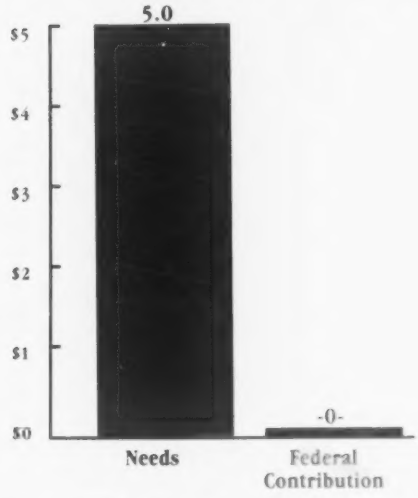

Sources: *The Bond Buyer*, federal budget documents, Associated General Contractors needs study

[Recess.]

Mr. SAVAGE. Let us resume the hearing. I want to welcome Sharon White, Past President of the National Association of Bond Lawyers. She is of the firm of Jones, Hall, Hill and White, of San Francisco, California.

Ms. White?

TESTIMONY OF SHARON S. WHITE, PAST PRESIDENT, NATIONAL ASSOCIATION OF BOND LAWYERS, AND SENIOR TAX COUNSEL, JONES, HALL, HILL & WHITE, SAN FRANCISCO, CA

Ms. WHITE. Thank you, Mr. Chairman and members of the subcommittee. I have provided some testimony to you, and in the interest of time, I thought that I would focus on summarizing it.

Mr. SAVAGE. Let me say that your full statement will be put into the record—without objection, so ordered.

Ms. WHITE. Thank you very much. At the beginning of the statement, I outlined my background a little bit by way of demonstrating that I am and have been for some 20 years deeply involved with the financing of state and local government infrastructure, and am familiar with intricacies of tax-exempt bonds. Before I became involved with state and local government directly, I worked with the Federal Government with the Economic Development Administration, and I participated in legislative drafting which amended the Public Works and Economic Development Act of 1965. This bill is, in part, amending that Act, so I am familiar with that Act as well.

On behalf of the National Association of Bond Lawyers, I would like to state that we, as bond lawyers, support this legislation, in particular the provisions which would increase the small issuer exemption from rebate, and the provisions which would increase the private use limitation. We have three reasons for our support of the increase of the rebate exemption to $25 million, from its present level of $5 million.

The first is that the rebate provision is deceptively simple in its wording, but extraordinarily complex in its implementation. The two witnesses who appeared prior to me attempted to emphasize its complexity, and I would like to further emphasize its complexity. For example, the very first thing that a finance director like Mr. Glisson must do in order to satisfy the rebate regulations is that he must identify the proceeds of the bonds that are subject to rebate. While one might think that it is just the proceeds that are going to be used for construction, in fact, there are ten different kinds of proceeds of the bonds that are identified in interim regulations of the Treasury Department. It is not only the proceeds that the city receives from the underwriter on the purchase of the bonds, but it is also the investment earnings on those proceeds, it is transferred proceeds, sinking fund proceeds, reserve funds, even though the city puts up its own reserve fund and it is not proceeds of the bonds at all, and all amounts used for investing of those amounts.

Mr. SAVAGE. Please proceed Ms. White. We will have approximately seven or eight minutes before we will have to leave for the vote.

Ms. WHITE. Fine. After identifying the proceeds for the purposes of rebate, the finance director must go through a number of allocations, old fashioned bookkeeping methods, etc. The ramification is that it is expensive for the city, and then the city will, therefore, probably decide to hire outside consultants to do it for the city. I put some figures in my testimony regarding the expense of outside consultants. In sum, though it appears simple on its face, it is not simple at all. It is very complex and it is beyond the capacity of most finance directors that I know.

The second reason that NABL supports the increase of the small issuer exemption from rebate is that it was adopted because it was concluded, as indicated in the blue book, that arbitrage was a substantial incentive for State and local governments to issue tax-exempt bonds. That is simply not true, in the context of small issuers, as well as in the context of large issuers. Under existing regulations, as well as the regulations that existed before the 1986 Act, issuers were required to use earnings to down-size their project, to actually apply the earnings to the financing of the project that was being undertaken. They did not invest money or gamble or pocket the money and use the arbitrage for other purposes. It is a falsehood that arbitrage was a substantial incentive for the issuance of tax exempt bonds therefore the penalty that was imposed, and it was admittedly a penalty, the penalty of rebate, is based on an improper premise. So for that reason NABL opposes the rebate, generally, and supports the increase of small issuer exemption.

The third reason that NABL supports the increase of the small issuer exemption is the application of the small issuer exemption will cause the down-sizing of the principal amount of bonds, rather than the increase of the principal amount of bonds, with the result that the revenue lost to Federal treasury from tax-exempt interest will go down. This is true for two reasons. One is that the arbitrage is required to be used for the project, so instead of having a $10 million bond issue, you would have a bond issue of a principal amount equal to what you need, minus the interest earnings. Secondly, because of the complexity of rebate, issuers will try to fall within the small issuer exemption. We do over two hundred financings per year, and 75 percent of the bonds that we do are under $25 million. There will be an effort to keep the size of the bond under $25 million in order to avoid the complexity and expense associated with rebate.

NABL also supports the increase of the private use limitation from 10 percent to 25 percent, and I have set forth in my testimony some specific examples of particular clients of mine that have occurred within the last six months. When I found out that I was going to be testifying, I just looked at recent examples. This is not to say that these are unusual examples. The fact that I could pull out eight or nine examples just based on last six months indicates the difficulty caused by the 10 percent private use test. I cite, for example, a city which wants to expand the street that is the gateway exit to the city. Underneath that street are privately owned public utility lines, providing gas and electricity to the city. The cost of relocating those lines is more than 10 percent of the bond issue, and as a result, the city cannot issue those bonds. The bonds would be taxable if issued, and we could not provide our opinion. I

provide the example of a city which, through historical developments, has half of its water provided by a governmental entity while the other half is provided by a water company. The city would like to expand all water lines to increase fire protection in the city because there are a lot of older wooden buildings. The city is South San Francisco and the buildings date from somewhat after the earthquake. If they issue bonds for that purpose, more than 10 percent of the proceeds would be used for private water company lines, with the result that the bonds would be taxable. I provide the example of a city which recently issued bonds to acquire a building for a library. Because it was a larger building, they want to rent out a portion of the building while they are waiting for the library to expand. The portion of the building would be more than 10 percent, so they are forced to either not to rent it out, to leave it vacant, or to cap the rent at an uneconomical and inefficient level. I cite the example of a senior citizen center, and a teen center, where the city, to accomplish its purposes, wants to use a portion of the facility for non-profit corporations, to provide advice on drug abuse, to provide recreational services, and the like. That portion is more than 10 percent, less than 25 percent, so the city can't do that because the bonds would be taxable.

I cite the city of Santa Rosa, which recently issued bonds for waste water treatment, because they were having difficulty with groundwater pollution, and were asked by the Environmental Protection Agency to clean up the problem.

Mr. SAVAGE. If you will excuse me, Ms. White, may I interrupt you. We are at the time required to go and vote. You can choose to either quickly sum up your testimony or to suspend it while we go over and vote, which will take us about ten minutes. You may do whatever you choose.

Ms. WHITE. If you would like for me to come back, I will be happy to do whatever is suitable for you.

Mr. SAVAGE. All right then, we will have to recess to vote, and we will resume at this point of your testimony in about ten minutes. Thank you.

Ms. WHITE. Thank you.

[Recess.]

Mr. SAVAGE. Ms. White, we thank you for your patience. We remind you, of course that your written testimony will be a part of the record.

Ms. WHITE. I was citing examples of how the private use limitation affects the financing of traditional public works. I had related to several. I was just about to mention the example of the financing of wastewater treatment facilities to overcome groundwater pollution problems.

The treated effluent is frequently sprayed onto agricultural lands to assist in growth, obviously, of agricultural crops. That is a private use of bond proceeds. In the case of this particular city, they will be forced either not to spray, and hold it and dispose of it in some fashion, or to spray it for free because of the limitation caused by the private use test.

Another example which I cite is a transit district which in the last month issued bonds to acquire a building to be used for its administrative office needs. The building is a little bit larger than

they need. They would like to rent out the top floor until they need to use it for district purposes. For them to rent out the top floor will cause the bonds to be taxable. They will be forced to leave it vacant or rent it at uneconomic levels.

I also refer to numerous redevelopment agencies in the State of California, as well as in other States, which are continuing with their redevelopment activities to renovate deteriorating areas, particularly in the downtown areas of larger cities. Redevelopment agencies acquire land and transfer it to private persons. Private persons clear the land and build affordable housing for low and moderate income people.

The private use restriction prevents redevelopment agencies from doing that on a basis other than giving away the land for free. Since the Tax Reform Act of 1986, numerous redevelopment agencies in California have given away millions of dollars worth of land, an asset of the local governmental entity, in order to achieve their public purposes because of the private use limitation.

I also call your attention to the fact that parking is a major problem not only in California, but in many cities. To the extent that the parking is located adjacent to office buildings, shopping centers, and the like, the owners of the office buildings, shopping centers, and the like would like to have some dedicated spaces to use for their customers and employees. To the extent that the dedicated spaces would exceed 10 percent of the parking facility, they will be unable to do that without causing their bonds to be taxable.

Finally, I speak of the improvement of streets. There is hardly a street with which I'm familiar that doesn't have underground utility lines. To the extent that there are streets that need improving in older areas that have overhead utility lines, there's always a desire to bring the overhead utility lines and put them underneath the street.

If you're financing the streets with bonds, no more than 10 percent can be used for moving those utility lines. Frequently, the costs of relocating the utility lines are more than 10 percent but less than 25 percent. We could have lived—and we did live for many years—with the 25 percent test. It's the 10 percent test that is causing us not to be able to issue tax-exempt bonds for financing of streets.

So in sum, notwithstanding the reference and the blue book to the fact that the intent of Congress was to enable State and local government to continue to finance traditional activities, the effect of the 10 percent private use test has caused them not to be able to finance traditional activities.

We're not speaking of a boondoggle for private enterprise. We're not speaking of helping finance private enterprise. We're not even speaking about job creation. We're speaking about the fundamental ability to issue tax-exempt bonds for basic public works, infrastructure that is needed in our States and on our local government level. The increase of the limitation from 10 percent to 25 percent will enable us to continue tax-exempt bonds for these purposes.

Mr. Glisson referred to the fact that the National Association of Bond Lawyers would suggest to you that a further modification of the language is necessary because there is also an associated re-

quirement that says: not in excess of 5 percent may be expended for an unrelated use.

Of the nine examples that I gave you, four of them could not be done because of the 5 percent test. For example, if you are building a—in the case of my transit district where they acquired a building to be used for transit district purposes and would lease out the top floor, that would be considered an unrelated use. Similarly, in the case of the city that would spray effluent on agricultural land, agricultural use is not related to city use. That would be an unrelated use. Therefore, it would be subject to a 5 percent test.

Most redevelopment agency activity is unrelated use and subject to a 5 percent test. So the National Association of Bond Lawyers would encourage you not only to increase the 10 percent test to the former 25 percent level at which it was, but also to eliminate the 5 percent related use requirement or to increase it to a commensurate level.

The National Association of Bond Lawyers also supports, of course, the technical assistance provisions and the report contained in section 3 and section 4 of the act.

In conclusion, I would like to note that the Supreme Court has recently held that State and local governments may find redress for Federal wrongs through the national political process. We are asking for redress. We think that the bill pending before you will assist us. In my view, there is no question but that the rebate requirement is a Federal wrong, an ill-conceived tax based upon an inaccurate assumption that arbitrage is a substantial incentive to the issuance of tax-exempt bonds. Beginning with small issuers, the national political process should be employed to right this wrong. H.R. 3807 is a step in the right direction.

In my further view, the lowered private business tests imposed by the Tax Reform Act of 1986 constitutes a Federal wrong aimed towards the elimination of a perceived abuse but based upon the inaccurate, arbitrary, and factually insupportable conclusion that the lowered level would nevertheless enable State and local government to continue with traditional infrastructure financing. Beginning with small issuers, the national political process should be employed to correct this wrong. Again, H.R. 3807 will constitute a step in the right direction.

We would like to acknowledge our appreciation of the sponsors of this bill, Congressman Clinger and Congressman Howard, as well as the other co-sponsors of the legislation.

I would be pleased to answer questions which are posed by you. I want to thank you for the opportunity to testify on behalf of State and local government.

Mr. SAVAGE. On behalf of the committee, let me thank you, Ms. White, for how detailed you've been in your presentation. I do have a couple of questions however.

One: you gave the example, for instance, of the top floor of some transit facility in your area. You pointed out that because of the private-purposes limit with tax-exempt bonds, they would not be able to economically rent out that space. How is it that a public agency cannot economically rent out excess space if it had not been constructed from tax-exempt bonds, when most office facilities pri-

vately are constructed without tax-exempt bonds? Why is it that the public agency is so non-competitive?

Ms. WHITE. In this case, the public agency issued bonds to acquire a pre-existing building. The building has 10 stories. At the present time they only need 8 and a half stories. So the other story and a half they can leave vacant, or they can rent it out. If they rent it out at a level that produces an amount equal to more than 10 percent of debt service, the bonds will be taxable.

Mr. SAVAGE. No. I understand. Pardon me, Ms. White. I understand that.

What's bothering me is this. Private real estate developers develop both old and new properties. They rent out space without, in most instances, tax-exempt loaning privileges. They do so at a profit.

You cite instances where you contend that it is necessary that public agencies also developing properties where there is excess space are unable to rent this out economically without tax-exempt financing even though the public agency is not required to make a profit on the rental. I don't understand why there is such uncompetitiveness.

Ms. WHITE. They are unable to rent it out economically because of tax-exempt financing. If they had not issued tax-exempt bonds to acquire the building—for example, in the case of my library—the building which they are going to use for the library, they could have rented the excess space at a fair market value level. The tax-exempt bonds prevent them from being able to rent this space at a fair market value level. They are forced to rent it at less than fair market level or leave it vacant.

Mr. SAVAGE. Now explain that to me. That I don't understand. They are required to rent it at below market value?

Ms. WHITE. Yes.

Mr. SAVAGE. Explain that to me.

Ms. WHITE. Because if they rent at market value, that will produce an amount in excess of 10 percent of the annual debt service on the bonds. It will cause the bonds to be taxable.

Mr. SAVAGE. Run that by me again.

Mr. MCEWEN. If they're doing that, and if they're making money, they've got no problem paying the——

Mr. SAVAGE. That's my point.

Excuse me just a moment. Mr. McEwen, would you repeat what you said. Yes. That's my problem.

Mr. MCEWEN. The dilemma here is that if they charge more and make an excess profit, therefore, they no longer qualify for the exemption. But that doesn't make any difference because they're making lots of money; so they don't need the exemption. So either way I think it's kind of——

Ms. WHITE. That's a facetious argument.

They do need, particularly in the case of both the transit district and the——

Mr. MCEWEN. That's not my argument.

Mr. SAVAGE. Let me just thank—I'm glad that I permitted my colleague here to explain it. Go ahead.

Ms. WHITE. Cities need city halls. Library districts need libraries. Transit districts need administrative facilities. If there's any excess

space in those facilities and they lease it to a private company—which is a businesslike thing to do—and it's more than 10 percent, the bonds are taxable. To say that—well, they do make the choice that you're talking about. They can not have tax-exempt bonds and acquire the building. Or they can have tax-exempt bonds and not lease the space.

Mr. SAVAGE. I understand. Thank you.

Let me ask the second question. The effect of using tax-exempt bonds for what is a private activity—say the portions of the building that are rented to a private concern—does that not, in effect, constitute a kind of a Government subsidy with regard to the tenancy?

Also, when you make reference to using this bonding authority to a certain percentage that you wish to increase for admittedly private activity, does that not circumvent the reduction in other economic development programs?

This very subcommittee which has jurisdiction with regard to the programs and the financing of the Economic Development Administration of this Government was unable this year to get an authorization bill enacted or to increase appropriations for the Economic Development Administration because of the budget deficit. Now some of those programs would allow for private development. Does not this effort tend to circumvent the problem that the appropriations of the House has been unable to handle because of the deficit crunch?

Ms. WHITE. There is really two points to make.

We are not talking about private activity bonds. We are not talking about issuing bonds and making a loan to a factory or a shopping center. We are talking about infrastructure. We are talking about an incidental private use that results from the construction of infrastructure.

So to the extent that EDA was seeking money, for example, as a part of their business loan program to assist private enterprise, we are not talking about that.

Mr. SAVAGE. Let me understand you then, Ms. White.

This bill before us includes this. In addition to the problem that you just addressed now, it also includes a provision to increase to 25 percent from 10 percent the amount of tax-exempt Government bond proceeds that may be used by a non-governmental entity for private purposes. From what you just said, am I to conclude that while you favor H.R. 3807, you do not favor that particular provision?

Ms. WHITE. No. We do favor that provision. The private use in question is incidental to the public use. Instead of being 10 percent incidental, we're asking for 25 percent incidental. It's a building-by-building basis.

Mr. SAVAGE. What I am asking is: to raise that you increase the amount that a non-governmental entity can use for private purposes—that's what it says—for projects that are not now funded, or may not be funded by this Congress because of the budget deficit. I'm asking: are you not making an end run, circumventing that problem by increasing the amount that you can use for private purposes out of tax-exempt bond proceeds?

Ms. WHITE. You may be suggesting that the tax exemption is a loss of revenues to the Federal Government. But we understand this committee is concerned with infrastructure financing.

Mr. SAVAGE. I'm not talking about infrastructure now. I'm talking about current governmental entities for private purposes. Now that's a provision of H.R. 3807. I'm trying to understand whether you also favor that provision.

Ms. WHITE. We favor the provision. The provision is infrastructure.

Mr. SAVAGE. Thank you.

Mr. McEwen?

Mr. MCEWEN. Thank you, Mr. Chairman.

The only thing I would say, Ms. White, is thank you very much for your testimony. It's very effective. Of course, as you know, I strongly agree.

I would only leave this message. The concerns that the Chairman has expressed and that the Congress has with these amendments basically come, in my judgment or observation, from the encouragement of bond council and underwriters.

The South Tulsa example where they floated the bond, the underwriters made a percentage, the city council made a boatload, and then they paid off the bonds after three years—and there was no intent ever to construct anything—gave rise to the sort of restrictions that we face. Our research has discovered that most were not the instigation of local sewer districts or the brain child of the local councilmen, but those bond councils that went from Government entity to Government entity showing an opportunity for not necessarily a quick buck, but money that increased their coffers without providing the service that was intended by this section of the law.

We're going to try to tip toe back from it. I'm not sure how successful we'll be.

Ms. WHITE. Could I state one thing? Those are private activity bonds.

Mr. MCEWEN. Yes.

Ms. WHITE. Which are not being considered here.

Mr. MCEWEN. Well, the South Tulsa one was ostensibly for a housing project, I guess.

Ms. WHITE. Private.

Mr. MCEWEN. Well, it was for the housing authority.

Ms. WHITE. Private activity bonds.

Mr. MCEWEN. All right.

So you understand the dilemma that we've been put in. I know of no better conduit from which the message should be carried than the National Association for Bond Lawyers. I appreciate your coming. Thank you.

Ms. WHITE. Thank you very much.

Mr. SAVAGE. And now for the newest member of our committee, less than two months a member of this body, but who hit the ground running. An evidence of that fact is that with his turn for questioning, we're going to turn over to him the gavel. Our good colleague, an esteemed member from Virginia, Lewis Payne.

Mr. PAYNE [acting Chairman]. Ms. White, I, too, want to thank you for your testimony. I thought it was very enlightening and very helpful to us as we consider this legislation.

I did have one question—following up on the Chairman's questions and comments—that had to do with your example of the structure that was 10 stories, 8 and a half of which would be public and 1 and a half private. Are there ways to have a bond instrument such that you could have a portion of it—in this case, 85 percent of it would be tax-exempt—floated at a tax-exempt. The remaining 15 percent would be floated at a market rate to equate, if you will, the private and public financing with the private and public uses?

Ms. WHITE. Literally, the answer is no. But generally, you could have two separate bond issues—not a part of the same instrument—one taxable and one tax-exempt.

However, in the case of both the library entity and the transit district, they didn't have sufficient funds to be able to pay back at taxable rates. So it's better for them to leave the space empty. That's an incorrect result. It's untenable.

Mr. PAYNE. So it is possible to have the first level secured and the other one be secondary to that and to have that be co-secured, if you will?

Ms. WHITE. Yes. You would have two separate liens. You would issue the bonds 31 days apart. But, of course, in the case of these two entities, the taxable bond would not be marketable. There simply weren't enough tax revenues or other revenues whether they leased the space or not to pay a taxable rate.

Mr. PAYNE. Thank you.

I have no other questions. I think the committee has no other questions. Again, we very much appreciate your testimony. We appreciate your being here to give it to us. Thank you.

Ms. WHITE. Thank you very much.

[Ms. White's prepared testimony follows:]

Testimony

of

Sharon Stanton White

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and

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before the

Subcommittee on Economic Development
Committee on Public Works and Transportation
U.S. House of Representatives

August 10, 1988

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Mr. Chairman and Members of the Subcommittee. My name is Sharon Stanton White. I am the Immediate Past President of the National Association of Bond Lawyers, having served as President from October 1986 until October 1987 during the implementation phase of the Tax Reform Act of 1986. The Association (sometimes referenced as "NABL") is comprised of approximately 3000 attorneys who represent state and local governments throughout the United States in the issuance of tax-exempt bonds. Such bonds are publicly and privately marketed with the accompanying opinion of such attorneys, and the proceeds of such bonds are used by state and local governments to achieve their public purposes.

I am also the senior tax counsel with the law firm of Jones Hall Hill & White, in San Francisco, California. Such firm acts as bond counsel for approximately 200 tax-exempt bond financings each year and ranks approximately 13th among bond counsel firms in the volume of tax-exempt bonds in the United States. Of the financings reviewed by the firm each year, approximately 73 percent are in a principal amount of $25,000,000 or less, and about 74 percent are governmental bonds issued for public works or cash flow purposes. The client base of the firm is therefore largely comprised of small issuers which undertake financing for governmental, rather than private activity public purposes.

Prior to becoming a bond counsel in 1972, I was, for three years, an Attorney Advisor with the Economic Development Administration of the United States Department of Commerce ("EDA") and in such capacity both drafted legislation for amendment of the Public Works and Economic Development Act of 1965 (which Act is proposed to be amended by the legislation under consideration today) and advised the Economic

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Development Administration in the legal aspects of grants and loans to local government for public works.

Based upon my experiences as NABL President, as a practicing bond lawyer and as an Attorney Advisor with EDA, I am familiar with the infrastructure and public works needs of local government, with the intricacies of tax-exempt bond issuance and with the intergovernmental considerations regarding the financing of local public works. I very much appreciate your invitation to appear before the Subcommittee and to express the views of NABL with respect to H.R. 3807.

The National Association of Bond Lawyers strenuously supports H.R. 3807 and, in particular, section 5(a) thereof which would increase the small issuer exemption from rebate requirements from $5,000,000 to $25,000,000 and section 5(b) thereof which would increase the level of the private business tests from 10 percent to 25 percent.

The Small Issuer Exemption from Rebate.

As the members of the Subcommittee are aware, the rebate requirement was added to the Internal Revenue Code by the Tax Reform Act of 1986. Under the provision, an issuer of tax-exempt bonds is required to rebate to the United States an amount equal to interest earnings on bond proceeds above bond yield. The provision does not apply to "small issuers" of tax-exempt bonds; that is, it does not apply to issuers of less than $5,000,000 principal amount of bonds in the calendar year. Section 5(a) of H.R. 3807 would increase this exemption to $25,000,000, that is, it would classify as "small issuers", for the purposes of the rebate requirement, those issuers which issued less than $25,000,000 (rather than $5,000,000) in a calendar year.

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NABL supports this amendment for three reasons: first, the rebate requirement imposes a complexity beyond the administrative and monetary resources of most small local government issuers, and the amendment would effectively eliminate the needless and wasteful expenditure of such resources caused by the requirement; second, the rebate requirement was enacted, not as a federal revenue source, but rather as a penalty for arbitrage abuse, and the amendment would correct the mistaken assumption that small issuers have either the opportunity or the inclination for arbitrage abuse; and third, elimination of the rebate requirement for small issuers will tend to minimize the principal amount of tax-exempt bond financings and thereby decrease, rather than increase, any reputed revenue loss to the federal government caused by the availability of the exclusion from gross income of interest on local government bonds.

Administrative Complexity.

On its face, the rebate requirement is deceptively simple: interest earnings above bond yield must be rebated to the United States. In its implementation, however, the rebate requirement is extraordinarily complex.

Consider, for the moment, the position of the finance director of a small city which has recently issued $10,000,000 principal amount of bonds to finance water improvements and to refund an outstanding bond issue so as to eliminate the prior lien of such issue on the water revenues required to pay the new bonds. With diligence, such finance director will commence the process for computation of the rebatable amount, if any.

The first rule which the finance director will learn is that the interest earnings which must be examined to determine whether an excess (rebatable) amount exists are interest earnings on "gross proceeds" of the bond issue. Under present regulations (to

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which the officer may or may not have access in the small city), there are ten types of gross proceeds. Thus, the finance director will be required to examine interest earnings not only on the original proceeds of the bonds which the city received to construct the water system, but also on nine other types of proceeds: (1) the investment proceeds (interest earnings on the original proceeds, other than the original proceeds to be used to pay expenses of issuing the bonds), (2) the transferred proceeds (proceeds of refunded bonds which remain in existence on the date of issuance of the new bonds and which the finance director learns are to be considered as transferred ratably as proceeds of the new bonds is used to pay principal of the prior bonds), (3) the sinking fund proceeds (amounts deposited in debt service funds to be used to pay principal and interest due on the new bonds), (4) amounts deposited in a reserve fund for the bonds (even though such amounts may not have been proceeds of the bonds but were contributed by the city), (5) securities pledged for the payment of debt service on the bonds, (6) amounts received on acquired purpose obligations of the bonds, (7) other amounts used to pay debt service on the bonds, (8) amounts deemed to be replaced by the proceeds of the bonds and (9) amounts received as a result of investing all of the foregoing amounts.

Being patient, the finance director will accomplish the work necessary to identify all of the above proceeds. Beyond deciphering the language necessary to identify the above proceeds, the finance director may find, for example, that some of the above amounts are comingled with general city revenues or water revenues and an allocation is required between interest earnings potentially subject to rebate and those not potentially subject to rebate; the finance director may find that a bond trustee holds some of the proceeds and that the trustee is unable to explain where all of the amounts were invested; the finance director may find that an amount was overpaid to, for example, a

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title insurance company and will wonder, when the overpayment is refunded, how the amount was invested while it was not within the city; the finance director may wonder whether the accrued interest paid on the purchase of the bonds is encompassed within any of the above categories of gross proceeds; the finance director may discover that not all of the amounts in the issuance costs account were expended for issuance costs and that a reconciliation is required to discover interest earnings not allocable to issuance costs; the finance director may discover that some amounts believed to be invested in an interest-earning security were in fact used for a brokerage commission; the finance director may wonder whether the $8.50 left over on completion of construction of the project may simply be ignored; and the like. The practical problems involved in the mere identification of gross proceeds are numerous, difficult and unpredictable.

Nevertheless (to continue with the example), assume that the finance director accurately identifies each amount of gross proceeds of the bonds, that he identifies each investment made with the gross proceeds, and that he has added together the total interest earnings. The finance director is then ready for the next step: determination of the "excess" investment earnings. This will involve a computation of the actuarial yield on the bonds (which he may or may not be able to accomplish), based upon the reoffering price of a substantial amount of the bonds of each maturity (which he may or may not know) taking into account municipal bond insurance premiums as interest (which he may or may not be able to do); and an application of the method which has been most recently announced as the correct method (now variously labeled as the "exact" or "future value" method) for the determination of the accurate amount of excess investment earnings above bond yield.

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At this point, the finance director of a small issuer will realize that the complexity is beyond his experience, or that he simply does not have the hours required to complete the calculation (given his ordinary responsibilities as a local finance officer), or that he lacks the confidence to believe that his computation will be correct and that taxability of the bonds will be avoided. He may, therefore, turn to an outside consultant.

Use of a consultant for computation of the rebate amount will entail an expenditure of local government funds which are already severely strained. An outside consultant will generally charge an acceptance fee of $500 to $1500 and an annual computation fee of $2,000 to $20,000. The acceptance fee is a one-time fee required upon execution of a contract for computation services with the consultant, and the computation fee is a fee which is required to be paid each year during the term of the bonds. In the case of a thirty-year bond term, therefore, the second fee would range from $60,000 to $600,000 over the term of the bonds, whether or not rebatable amount existed.

While a large issuer of tax-exempt bonds may (because of the experienced or numerous staff of the issuer or because of the availability of revenues for payment of internal or external experts as a percentage of the total budget of the issuer) be able to accomplish compliance with the rebate requirement, the extraordinary administrative difficulty of implementation of the rebate requirement is beyond the means of most small issuers of bonds; and the time-consuming and monetary costs of the rebate requirement are beyond the resources of most small issuers of bonds. In order to alleviate such difficulties and eliminate such burdens, NABL favors an increase in the small issuer exemption amount from $5,000,000 to $25,000,000 as is provided by section 5(a) of H.R. 3807.

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Inappropriate Application of Penalty.

NABL also favors increase of the small issuer exemption to the rebate requirement because the rebate requirement was enacted as a penalty for abuse of arbitrage rules and small issuers, by their nature, neither have the opportunity, nor the inclination, to abuse arbitrage rules. The General Explanation of the Tax Reform Act of 1986 prepared by the staff of the Joint Committee on Taxation states, for example, as follows:

> The ability to earn arbitrage profits provides a substantial incentive for qualified governmental units to issue more bonds, to issue them earlier and leave then outstanding longer than they otherwise would. (General Explanation, at pages 1154-1155.)

It is incorrect to conclude that the ability to earn arbitrage profits provides a substantial incentive to small issuers of governmental bonds. First, it is frequently, if not generally, the case that small issuers of tax-exempt bonds lack the knowledge deliberately to issue bonds for the purpose of making an arbitrage profit; the focus of the elected and appointed representatives at the time of bond issuance is upon the project to be financed rather than upon excess spread which may be available from investment of bond proceeds.

Second, due to the inherent nature of small issuers, officials thereof are frequently closer to the residents and taxpayers (their neighbors) of a local governmental unit than are officials of larger issuers. A bureaucracy is less likely to exist within small issuers and the consequent emphasis upon direct accountability of officials to residents and taxpayers acts as a catalyst for minimizing debt both in principal amount and in frequency of issuance. As debt is minimized, arbitrage opportunities are decreased.

Third, small issuers are less likely to command low interest rates on their bonds in the public markets than many large issuers, with the result that the interest rate on the

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bonds issued by small issuers is closer to the interest rate of taxable investments than is the interest rate on the bonds of large issuers. The arbitrage differential available for small issues is, therefore, often of little significance.

Finally, because the issue is small, the proceeds available for investment are small and any arbitrage which might be earned from the differential between tax-exempt and taxable rates is minimal.

For all of the above reasons, it is clearly not the case that arbitrage is a "substantial incentive" to small issuers of tax-exempt bonds. The imposition of the rebate penalty upon small issuers is inappropriate and represents a lack of understanding of the nature of debt incurrence by small governmental units. NABL therefore urges the increase in the small issuer exemption and supports section 5(a) of H.R. 3807 because it provides for such increase.

Decreased Principal Amount. The third and final reason that NABL supports the enactment of section 5(a) of H.R. 3807 relates to the intergovernmental allocation of resources. If the rebate requirement is improperly viewed as a "revenue raiser" for the federal government in that rebate is itself a payment which provides revenues to the federal government, it should be recognized that the increase in the small issuer exemption will not result in a commensurate decrease in rebate revenues to the federal government. This is clear for two reasons: first, under general arbitrage requirements without regard to the rebate provisions, issuers of tax-exempt bonds are required to use arbitrage earnings for the project financed and are not permitted to earn and keep arbitrage amounts. Thus, if the cost of a project to be financed is $10,000,000 and if it is expected that $500,000 will be earned from investments made with construction fund proceeds above bond yield as the construction fund is expended for the project, then the

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principal amount of the bonds is required, under existing arbitrage regulations, to be established at $9,500,000. If, on the other hand, the $500,000 earnings are required to be rebated to the United States, then the principal amount of the bonds will be established at $10,000,000. A larger principal amount of bonds will necessitate larger interest payments which, in turn, are tax-exempt, while the smaller principal amount will result in smaller tax-exempt interest payments. The rebate requirement, therefore, is not solely a "revenue raiser"; it is also a "revenue loser" to the federal government.

Similarly, because of the administrative and monetary restraints discussed above which are imposed by the rebate requirement, local government will seek to avail itself of the small issuer exemption. This in turn will produce an incentive for lowering the principal amount: an incentive which does not exist with the present small issuer limit. The cost of an ordinary and usual public work improvement will rarely fall within the $5,000,000 limit, while (based upon the statistics within my own law firm) such cost will more than usually fall within a $25,000,000 limit. The increase of the exemption amount therefore will encourage the downsizing of the principal amount of bond issues, a result favorable to the federal government as well as to state and local government.

Summary Regarding NABL Support of Increase of Small Issuer Exemption. In summary, therefore, NABL favors the increase of the small issuer exemption from $5,000,000 to $25,000,000 because it will enable the elimination of the insupportable administrative and monetary costs imposed upon small issuers by the rebate requirement; because it will rectify the improper premise of the rebate requirement that arbitrage earnings constitute a "substantial incentive" for the issuance of tax-exempt bonds necessitating the punishment of small issuers; and because it will encourage the minimizing of the principal amount of bonds and the consequent revenue loss (if any) to

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the federal government said to result from the tax-exemption of interest on the bonds of small issuers.

The Private Business Tests.

As the members of the Subcommittee are aware, under the Tax Reform Act of 1986, a bond is characterized as a "private activity bond" if it satisfies both the "private business use test" of section 141(b)(1) of the Internal Revenue Code of 1986 (the "Code") and the "private security or payment test" of section 141(b)(2) of the Code. The private business use test is satisfied if more than 10 percent of the proceeds of the bonds are to be used for a private business use. The private security or payment test is satisfied if more than 10 percent of the debt service on the bonds is secured by an interest in property to be used for a private business use or to be derived from payments in respect of property or borrowed money to be used for a private business use.

These tests differ from prior law in three respects: first, the permitted percentage under both tests is decreased to 10 percent from the 25 percent level permitted by prior law; second, the private security or payment test is deemed to be satisfied by indirect payments which are not used for debt service as well as direct payments which are used for debt service and to which prior law was limited; and third, present law establishes a level of 5 percent in the case of private use which is not "related" to the governmental use of proceeds, a restriction which did not exist under prior law. Section 5(b) of H.R. 3807 pertains only to the first modification referenced above and applies only in the context of certain issuers; that is, section 5(b) of H.R. 3807 would reinstate the 25 percent level of the two tests as applied to small issuers of tax-exempt bonds. It would not reinstate such level for large issuers of tax-exempt bonds, nor would it eliminate the indirect

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security or payment test imposed by new law, nor would it eliminate the related use requirement for amounts in excess of 5 percent of the proceeds of the bonds.

With one modification (discussed below), NABL supports the enactment of section 5(b) of H.R. 3807 as necessary to ensure the continued ability of small issuers to finance public works on a tax-exempt, cost-effective basis.

Examples.

At first blush, a theorist may propound that a 10 percent private business test level is more than sufficient to allow incidental private use which may result from a public works project; however, reality is a different matter. Consider the following examples taken recently from my own practice in California:

(1) The City of Vacaville, California, fronts Highway 80, a major freeway linking Sacramento and San Francisco. At the time of the founding of the City and the construction of the highway, a freeway interchange was constructed to provide for an exit from the highway to the City streets. The highway exit is linked to the gridiron of City streets through a single gateway City street. Extraordinary growth of the City has resulted in untenable traffic on the City, streets, which in turn has resulted in a bottleneck backup of traffic on both the exit lane of the freeway and the gridiron of City streets. Quite logically, the City plans to widen the gateway street through reconfiguration and relocation of the gateway street. In exploring the plan, however, the City has discovered that the reconfiguration will require the relocation of an underground 15,000 volt electric line through which the electric needs of the City are served. The line is owned by a privately-owned public utility. The cost of the relocation of the line is more than 10 percent, but less than 25 percent, of the cost of the street reconfiguration.

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The private utility is able to repay a portion of the relocation costs, but only over a period of years. Such payments will exceed 10 percent of debt service, but be less than 25 percent of debt service. Tax-exempt bonds cannot be issued for the project under present law.

(2) The City of South San Francisco, California, as a result of historical development is provided water from two sources: a public water district and a private water company. The City has determined that the water lines throughout the City are insufficient to provide for fire protection needs under modern standards. The City proposes the issuance of bonds to expand the water lines. The cost of the private water company lines is more than 10 percent but less than 25 percent of the total cost. The City is unwilling to improve the private water company lines without receiving payment from the private water company. The amount to be paid by the private water company would be more than 10 percent but less than 25 percent of debt service on the bonds. Tax-exempt bonds cannot be issued unless they are characterized as private activity bonds and receive a grant of volume allocation, if available, from the State of California.

(3) The Thousand Oaks Redevelopment Agency, in Thousand Oaks, California, recently issued bonds to acquire a building to be used for a public library and to construct a building to be used in part for a teen center and in part for a senior citizens' center. After review of many buildings in the area, it was determined that a particular building (a former super market) was appropriate in location and in cost for acquisition for use as a library. The building, however, is somewhat larger than required for present, though not future, library needs. The Agency, therefore, desires to lease a portion of the building to private business. The area leased will be more than 10 percent, but less than 25 percent, of the total area of the building and rental payments will exceed

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10 percent of the present value of the portion of debt service on the bonds allocable to acquisition of the building. The Agency, therefore, must either rent the excess portion of the building to governmental units (for which no interest has been shown), rent the excess portion of the building to private business on an uneconomical basis by capping the rent at an amount which will be less than 10 percent of debt service, or leave the excess portion vacant. While tax-exempt bonds have been issued, the 10 percent limitation has forced unbusinesslike, uneconomical choices upon the Agency.

With respect to the new teen center and the new senior citizens' center included in the same bond issue, the Agency wishes to lease an area in excess of 10 percent of the center to one or more nonprofit corporations. Such desire is motivated by two factors: first, the Agency would like to provide nonprofit program benefits, such as counseling, recreation services and the like, to users of the centers; and second, the Agency would like to obtain nonprofit corporation rent to defray the costs of maintenance of the building. Due to the expected heavy usage of the building, maintenance costs are expected to be substantial. Again, while tax-exempt bonds have been issued, compliance with the 10 percent limitation will both minimize the accomplishment of the program aims of the center and force the Agency to divert general fund revenues for maintenance of the center. Private activity bonds could not have been issued to finance the center as some of the nonprofit corporations in question are not qualified 501(c)(3) corporations.

(4) The City of Santa Rosa recently issued tax-exempt bonds for wastewater treatment facilities. Treated effluent will be disposed of on agricultural lands. At the present time, the owners of such lands do not pay for such irrigation water. It is expected in the future, however, that agricultural land usage will become more intensive and that alternative irrigation sources will become insufficient. As a consequence, it is

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expected that agricultural users will be more than willing to pay for the treated water from the financed facility. Because the portion of the facilities devoted to transmission lines for the treated effluent, together with the private uses described in the next paragraph, exceed 10 percent, it will be necessary to cap the amount paid by agricultural users for treated effluent at a level not in excess of 10 percent of debt service. A 25 percent level would avoid this result.

The project referenced in the preceding paragraph also involved a transmission line to a city-owned golf course. Treated effluent will be used for golf course irrigation. The golf course, however, is operated by a private company under a long-term contract with the city. Revenues from the golf course will apply to the security or payment test. In addition, the City plans to investigate, in common with other U.S. cities, the sale of sludge produced by the plant for use as fertilizer. Such sales would produce revenue to be applied to the security or payment test. Receipt of payments by agricultural users, of golf course revenues and of sludge sale revenues on the expected projected levels will cause the bonds to be taxable private activity bonds. To avoid this result, the City will be required to limit one or more of such revenue sources to a level below projections. An increase to 25 percent from 10 percent for the two tests will enable better, more cost effective, more efficient planning by the City of its financed facilities.

(5) The A/C Transit District located in northern California recently issued bonds to acquire an existing building to be used for administrative office needs. One to two stories of the ten-story building are not presently required by the District, but will be needed in the future. The District would like to lease the excess space to private business rather than to leave it vacant. It is probable that total rent paid under fair market value private leases will exceed 10 percent of debt service. To avoid taxability of

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its bonds, however, the District will be forced to cap private use rent at a below-market level. With a 25 percent test, however, the District would be permitted to negotiate rentals at a level which more closely approximates fair rental values and would thereby be enabled to proceed in a reasonable and businesslike manner.

(6) Numerous redevelopment agencies in the State of California (as well as in other states) are continuing with redevelopment activities for the purpose of renovation of deteriorating areas. Property tax differential revenues are used for payment of debt service on bonds issued to acquire and clear land for such purpose. In accordance with historic governmental procedures, acquired land will be transferred to private enterprises subject to disposition agreements containing covenants requiring sound planning, stable construction, appropriate location, and other provisions aimed towards creating safe, sanitary and attractive downtown communities and affordable housing for low and moderate income residents. Notwithstanding that such land is a valuable asset to the redevelopment agencies, because of the 10 percent security or payment test, the agencies are forced (in order to achieve their public purposes) to transfer land at no cost or at an amount which is substantially less than value. A 25 percent level, however, would enable agencies to recover a larger percentage of costs expended for land acquisition and clearance and to proceed in a more cost-effective and efficient manner than such agencies are able to proceed at the 10 percent level.

(7) Parking continues to be a major problem facing local government in California. While tax-exempt bonds may be issued for parking, the nature of urban communities is such that parking facilities are frequently located adjacent to privately-owned buildings whose owners are required, under the terms of private financing documents to maintain a limited amount of dedicated parking spaces for employees or customers. While a 10

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percent test permits some dedicated parking, the percentage is unreasonably low in most instances. A 25 percent test would alleviate the difficulty faced by local government in providing for the financing of such facilities.

(8) The improvement of streets in older areas, as well as in growth areas, is a common need in California and is ordinarily financed with tax-exempt bonds. Gas and electricity in most areas in California, however, are provided by privately-owned public utilities. When street improvement occurs in older areas, it is generally desirable to place overhead utility lines under the streets and when street improvement occurs in newer areas, it is generally desirable to include underground conduits and lines for utility purposes. A 10 percent level for the private activity tests causes street financing to be extraordinarily difficult and sometimes impossible, while the former 25 percent level proved to be reasonable. A return to the 25 percent level, particularly in the case of small issuers, will enable continuance of street improvement financing on a general basis.

Present Limit Does Not Retain Ability to Finance Traditional Activities.

The above examples are taken from my California practice and, I believe, based upon conversations with bond counsel in many parts of the country, are common examples of problems confronted by small local governments in the financing of traditional improvements.

The General Explanation of Tax Reform Act of 1986 indicates on page 1152, "The Act retains the ability of qualified governmental units to issue tax-exempt debt for the financing of traditional governmental activities." In view of the above examples, the validity of such statement is questionable. Section 5(b) of H.R. 3807 would further the original Congressional intent by enabling the financing of traditional governmental activities without promoting abuse.

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The General Explanation also indicates, on the same page,

> Congress believed that [the] diversion of governmental bond proceeds to non-governmental users should be limited, but without setting the threshold amount so low that de minimus or incidental usage of government facilities and services by private users might cause interest on an issue to be taxable.

NABL agrees that the threshold private business tests should be established at a level such that incidental usage of government facilities and services by private users does not cause interest on an issue to be taxable. As is indicated by the above examples, however, the threshold amount of 10 percent has not achieved this goal. At the 10 percent level, interest on bonds issued for traditional purposes is caused to be taxable by reason of incidental, proper private usage of government facilities. NABL therefore supports section 5(b) of H.R. 3807 which would increase the threshold level from 10 percent to 25 percent for small issuers.

We suggest, however, in the context of our support, that section 5(b) should further amend paragraph (3)(A)(i) of section 141(b) of the Code to provide for a commensurate increase of the permissible unrelated private use limitation. As now worded, such paragraph effectively limits unrelated private use to 5 percent, and the General Explanation indicates that related use is to be narrowly construed. Thus, in Examples (3) and (5) above, the lease of surplus space in the library building and in the transit district building will constitute unrelated use; in Example (4), it is probable that agricultural and golf course usage will constitute unrelated use; and in Example (6), the private use of land may constitute unrelated use. If the threshold of private business use is increased to 25 percent, but the unrelated use level is maintained at 5 percent, the problems outlined in Examples (3), (4), (5) and (6) above will not be alleviated. NABL

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suggests, therefore, that, for small issuers, the unrelated use threshold should be increased or eliminated.

NABL is particularly sympathetic with small issuers. The monetary resources of such issuers are limited, and an increase of the threshold of the private business tests in the case of such issuers will enable cost-effective, efficient and sound financings of traditional public works. Such issuers should not be penalized for the issuance of tax-exempt bonds by being forced to finance on an inefficient basis; such issuers should be encouraged to use their limited resources in a businesslike and effective manner; and finally, such issuers should be assisted in deriving revenues outside of tax-exempt bonds through the use of the bond proceeds as seed money for the development of healthy, stable and attractive communities.

Sections 3 and 4 of H.R. 3807

NABL supports section 3, providing for certain technical assistance to local government, and section 4, providing for a biennial report to Congress, of H.R. 3807. The biennial report, in particular, NABL believes, will provide needed information to Congress to enable complete analysis of local government financing needs and use of tax-exempt bonds as a primary financing source and will forestall inaccurate assumptions of the sort discussed above.

CONCLUSION

In conclusion, I would like to note that the Supreme Court has recently held that state and local governments may find redress for federal wrongs through the national political process. In my view, there is no question but that the rebate requirement is a

federal wrong, an ill-conceived tax, based upon an inaccurate assumption that arbitrage is a substantial incentive to the issuance of tax-exempt bonds. Beginning with small issuers, the national political process should be employed to right this wrong. H.R. 3807 will constitute a step in the right direction. In my further view, the lowered private business tests imposed by the Tax Reform Act of 1986 constitute a federal wrong aimed towards the elimination of a perceived abuse but based upon the inaccurate, arbitrary and factually insupportable conclusion that the lowered level would nevertheless enable the continuance of traditional governmental financing. Beginning with small issuers, the national political process should be employed to correct this wrong. Again, H.R. 3807 will constitute a step in the right direction.

I would be pleased to answer any questions posed by members of the Subcommittee and again wish to thank you for the opportunity to testify before you today.

Sharon Stanton White

August 10, 1988

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Mr. PAYNE. Next I would call the final panel.

With us today is the Honorable Morris Becker who is the Mayor of Eastlake, Ohio. He is accompanied by Franklin Sherkow, who is the Director of Transportation, speaking on behalf of the Northeast Ohio Areawide Coordinating Agency. Also, Mr. Lowell McCarty, Highland County engineer from Highland, Ohio speaking on behalf of the County Engineers Association of Ohio.

I yield to Mr. McEwen.

Mr. MCEWEN. Thank you, Mr. Chairman.

I would like to take this opportunity to welcome our panel here. Mr. Becker, as he will point out, has been a long time mayor of Eastlake, Ohio as well as representing the Northeast Ohio Areawide Coordinating Agency.

Also, it's good to have Mr. McCarty. Lowell McCarty has been president of the Ohio Association of County Engineers as well as a member of the Board of Directors for the transportation officials of ARTBA, American Road and Transportation Builders Association that is a major assist to those of us on the committee. He's a member of the National Highway Advisory Council and Chairman of the Ohio Valley Regional Public Works Committee.

Mr. McCarty is a well respected local engineer in southern Ohio and serves in an elected capacity for many years unopposed for re-election, which is a test of the affection and admiration with which he is held. I consider him one of my closest friends. It's a delight to welcome him here as well.

Mr. PAYNE. Mr. Becker?

TESTIMONY OF MORRIS BECKER, MAYOR OF EASTLAKE, OH, AND FIRST VICE PRESIDENT OF THE NORTHEAST OHIO AREAWIDE COORDINATION AGENCY

Mr. BECKER. Thank you.

One of the questions I'd like to ask my colleague is: how do you run unopposed? [Laughter.]

Mr. PAYNE. I think we'd all like to know that.

Mr. BECKER. Let me begin by thanking you for allowing me to come before you, your ranking member representative, Mr. Bob McEwen, and each of the members of the subcommittee for the opportunity to testify before you today.

I will summarize my testimony today in the interest of time. If you have no objection, a full, written copy will be submitted for the record.

My name is Morris Becker. I am the Mayor of the city of Eastlake, Ohio, a community of 22,000 people in northeast Ohio. I have had the honor of holding this position for more than 13 years.

This year it is my honor and privilege to serve also as First Vice President of the Northeast Ohio Areawide Coordinating Agency, known as "NOACA," the metropolitan planning organization for greater Cleveland. Our organization is both owned by, and advocates the interests of 2.2 million people residing within the 172 jurisdictions of general purpose local governments within the five northeast Ohio counties of Cuyahoga, Geauga, Lake, Lorian, and Medina.

With me today, to my left, is Mr. Frank Sherkow, who is the Transportation Director of NOACA. We will both attempt to answer any questions you may have at the end of the testimony. In offering this testimony, it is my pleasure to speak on behalf of not only NOACA, but also the private sector.

In 1981, Cleveland formed a public/private partnership for the infrastructure financing which is now known as "Build Up Greater Cleveland." This group, and our Chamber of Commerce, "The Greater Cleveland Growth Association," have cooperated in the development of this testimony and fully support the positions presented herein.

Numerous studies support the fact that the public infrastructure investment plays a crucial role in economic development. Moreover, certain types of public infrastructure investment—especially transportation investment— influence economic development to a greater degree than other types of public spending. Therefore, it is in the national interest to develop an infrastructure investment strategy which best supports a sound national economy.

Local governments have been hard-pressed, of late, to maintain merely the current level of infrastructure, let alone embark on any major improvement projects. As H.R. 3807 states: general revenue sharing has been eliminated, Federal categorical grants have been reduced, and the current Federal laws have discouraged local governments from participating in the bond market.

As local governments are responsible for more of the infrastructure and more programs, while getting significantly less Federal help, local financing for infrastructure has increased. In Ohio, for example, local governments in our region imposed higher vehicle license fees. Our State government increased gasoline taxes. The voters of the State of Ohio approved a 10 year, $1.2 billion infrastructure bond issue.

However, even with this additional tax support, it is doubtful that we can maintain—in safe operating condition—our existing transportation facilities.

In a study just completed by NOACA, it was determined that the price tag for necessary bridge repairs, rehabilitations, and replacements just for the five-county greater Cleveland area of northeast Ohio is approximately $1.57 billion. A copy of this report is submitted for your use.

[Mr. Becker provided three reports which will be maintained in committee files: Transportation Funding Analysis; Bridge Infrastructure System Program Report, June 30, 1988; and, Transportation Financial Resources, July 1987.]

Mr. BECKER. This $1.57 billion needed for bridges is over 30 percent more than will be available for the entire State of Ohio over a 10-year period from the newly voter-approved bond issue. At the same time, only $346 million in Federal aid for this bridge repair work—which is just 22 percent of the funds needed to keep existing bridges open and operating safely—is available to us from the Highway Trust Fund.

Sadly, our experience in northeast Ohio is the rule rather than the exception.

H.R. 3807 will offer local governments additional means to make such problems a bit more manageable. The technical assistance

and the biennial reports that the bill proposes will offer medium and small-sized communities a great deal of very useful information. Also, the loosening of the rules for local governments with regard to arbitrage and private-activity bonds will help to remove the current disincentives for economic development based on government's participation in the bond market.

These are important, supportive steps toward effective and feasible economic development. We applaud and endorse them. At the same time, it is mandatory that the feasibility of bonds as a major source of financing for infrastructure not be overestimated.

For local bond financing of infrastructure to make sense, several changes, other changes in existing law, in addition to the provisions of H.R. 3807 are necessary.

Therefore, we respectfully offer the following suggestions:

First, the monies in the Highway Trust Fund should be fully distributed without continuing the record high balances that currently exist. This may mean setting higher obligation limits, removal of some categorical obligation ceilings, or both.

We also understand the likelihood of getting full release of the Highway Trust Fund in the near future is not very great. But you have our whole-hearted support in your effort.

Second, the role of Federal Government in infrastructure investment and economic growth should be re-examined from a much broader perspective. Regions that presently or potentially can contribute to a positive trade balance should be targeted for more of the Federal spending on infrastructure.

Third, in order to provide greater access to needed funds, the receipt of discretionary and emergency relief funds should not reduce the Federal-aid highway minimum allocations apportionment to any State. For example, 17 States presently eligible for minimum allocation funds gain absolutely nothing from receiving discretionary or emergency highway funding because each dollar received from these sources merely is deducted from their minimum allocation apportionment. By the way, the 17 States contain 47 percent of all deficient bridges on the Federal-aid system.

Fourth, and finally, designation of the Federal-aid highway system should be re-examined. Highway funds are distributed in many States based on the system of highways designated as most important to the economy of 20 years or 30 years ago.

Rather than exploring proposals that reduce the Federal-aid system and/or the Federal role, proposals should be considered which tie the classification of Federal-aid systems to modern demographic and travel patterns and modern economic development criteria.

Thank you for the opportunity to offer our comments and suggestions. H.R. 3807 presents us with an occasion to dynamically influence economic growth in our Nation. We can, through working together, improve both the infrastructure and the economy. H.R. 3807 is an important first step. I am pleased to offer the assistance of NOACA, the Greater Cleveland Growth Association, and Build-Up Greater Cleveland to this committee in its efforts to enact its provisions to build upon any of the concepts offered here.

Thank you very much.

Mr. PAYNE. Thank you very much, Mr. Becker.

Now we'll have the other panel member, Mr. McCarty, who will speak. Then we will have questions of both of you. Thank you.

TESTIMONY OF LOWELL McCARTY, COUNTY ENGINEERS ASSOCIATION OF OHIO

Mr. MCCARTY. Thank you, Mr. Chairman.

It gives me great pleasure to be here today, especially on the day that my own Congressman from my own home town has been raised to the ranking minority member. I first met my Congressman when he was sacking my groceries. My children could probably tell me some things—who went to high school with him—that we wouldn't want to repeat here.

The County Engineers Association of Ohio represents all of the 88 elected County Engineers in the State of Ohio. It exists to raise the technical and non-technical standards of service rendered to the general public by the County Engineers and their employees.

Our Association has for years been concerned with the deteriorating condition of the infrastructure within the State of Ohio. Old age and lack of adequate funding for maintenance and replacement have caught up with our highways, bridges, storm sewers, flood control facilities, sanitary sewers, water lines, and wastewater and water treatment plants.

Our engineers are faced with potential catastrophes on a daily basis due to the funding shortage in these areas. The County Engineers in Ohio are responsible for over 27,000 bridges and almost 30,000 miles of highway. In addition, counties are responsible for many thousands of miles of sanitary sewer lines. These facilities must safely serve the millions of people in Ohio on a daily basis.

The requirements for the performance levels of these services are becoming ever more stringent. Many of the standards that are set at a national level by Congress or by Federal departments add significantly to the local needs. Not too many years ago Congress passed a law that raised the load limits on trucks. This law has a significant negative impact on local roads and bridges. The design life for roads and bridges is directly related to truck loading. When these loads were increased, the anticipated life of roads and bridges was reduced. As a result, the need for local infrastructure dollars was increased.

The County Engineers Association of Ohio is dedicated to working towards a resolution to the problems relating to the existing infrastructure system in Ohio. To that end we will endorse and support H.R. 3807. We would, however, request that under section (C) on page 5 that public bridges, public flood control structures, public storm water collection and storage systems be included within the definition of a Public Works Facility.

The findings, contained in section 2 of H.R. 3807, we feel begin to address the current status of the local infrastructure issue. The statement of findings should go on to add that in these United States there is now a crisis related to the condition of our infrastructure. The facilities that exist now were built many years ago and are reaching the upper limit of their useful life. The infrastructure within our townships, villages, cities, and counties must be the number one priority for all levels of government. How can

any government provide the necessary basic services without an adequate transportation system, without an adequate supply of water, or without the ability to dispose of our wastes.

These items are the ones addressed every day by the County Engineers and other local governmental units within Ohio.

The available local funds are dramatically insufficient when compared to the level of service that we should be providing our citizens. As a part of our Association's public education campaign of Ohio's infrastructure problems, we provide information gathered from a survey of the County Engineers in Ohio. This survey indicated that the County Engineers needed to double and, in some cases, triple the funds currently available for their operations. Obviously, Ohio's situation is not unique in these United States. We only have to read the newspaper to become aware of the bridge disasters around the country, or water shortages, or problems with wastes.

Any type of legislative assistance towards improving the ability of local government to address the current and future needs to rehabilitate or replace our existing infrastructure will be supported and endorsed by our Association.

H.R. 3807 will assist local government in utilizing tax-exempt bonds and will increase the amount of these bonds available. The result will be to lower the cost of locally bonded projects.

The County Engineers Association of Ohio would like to thank you for this opportunity to provide input on this matter and would offer to provide other information on this resolution or any other that deals with the critical situation of our infrastructure.

Thank you.

Mr. PAYNE. Thank you, Mr. McCarty.

I'll yield to Mr. McEwen.

Mr. MCEWEN. Thank you, Mr. Chairman.

Thank you, all three of you, for coming and for your testimony today.

As you're well aware from having spent the last few hours with us, there are some of us that strongly believe that this is, at least, one avenue that we can use to do a lot of things that have to be done over the next couple of decades.

I cite specifically the situation in Ohio where the Attorney General has for some reason or another latched upon the deadlines that are established in the Clean Water Act. He is sitting on local governments unlike any experience that any other State is enduring. In fact, I have a meeting at 3:00 p.m. with the U.S. EPA to try and see how we're going to resolve the demands that are being made upon local communities and the limited access that they have to financing these projects.

Your testimony is very, very helpful. We are hopeful that in the next Congress that we can literally move something like this forward. Your testimony, encouragement, and offers of assistance mean a great deal.

Specifically, I would say that the Greater Cleveland Growth Association, Virginia Ainsley, is a tremendous asset to all of us in the Ohio delegation and to this committee in her knowledge, expertise, and tremendous willingness to work all hours of the day and night on projects that are helpful to us.

I would conclude by also saying, Mayor, that you made reference to one provision about taking these trust funds off budget, and that we have narrowly missed on more than one occasion by taking those trust funds off budget and releasing the billions of dollars that are pent up there for aviation, highways, bridges, and elsewhere.

With the new Commission that is working now to report back in December for the new President next year, they are very susceptible to including that. If they are not, I think that there is increasing sentiment towards getting those trust funds available for the purpose for which the funds were collected. I would not be nearly as melancholy as you may have been in your testimony that we couldn't get it done.

Mr. McCarty, I thank you again for you insights and your many years of service and leadership to engineering associations across our country. I repeat, your contributions here today have been a tremendous help on us building the record. So regardless of who the Chairman is next year on the subcommittee, we can hopefully have sufficient support to give to local governments—who are accountable, responsible, and must deal directly with the impacts of these decisions—the tools with which to resolve them. So I thank you all.

Mr. PAYNE. Thank you Mr. McEwen.

I, too, would like to thank the three of you for being here and for coming all the way from Ohio to enlighten us and to build the record. I think it is going to be very helpful to all of us as we consider this in the future.

I think, Mr. Becker, in your written testimony you said, in many ways—talking about the infrastructure needs that exist in Ohio—you were preaching to the choir. I think that is exactly right. I have had similar conversations with my people in Virginia. They have many of the same needs and share many of the same sentiments that certainly you have expressed. So as we continue to work on the infrastructure needs and as we continue to consider H.R. 3807, I am sure that we will continue to need support, help, and testimony from people such as yourselves. We very much appreciate what you have done for us.

[The prepared statements of Mr. Becker and Mr. McCarty follows:]

STATEMENT BEFORE THE ECONOMIC
DEVELOPMENT SUBCOMMITTEE OF THE
HOUSE COMMITTEE OF PUBLIC WORKS AND TRANSPORTATION

RELATING TO
HR 3807: LOCAL GOVERNMENT INFRASTRUCTURE
FINANCING IMPROVEMENT ACT OF 1987

BY
MORRIS BECKER
MAYOR OF EASTLAKE, OHIO
AND
FIRST VICE PRESIDENT OF THE
NORTHEAST OHIO AREAWIDE COORDINATING AGENCY

AUGUST 10, 1988

2217T

REPRESENTATIVE SAVAGE, CHAIRMAN
ECONOMIC DEVELOPMENT SUBCOMMITTEE OF THE HOUSE PUBLIC WORKS COMMITTEE

TESTIMONY

LET ME BEGIN BY THANKING YOU, MR. CHAIRMAN, YOUR RANKING MEMBER REPRESENTATIVE BOB McEWEN, AND EACH OF THE MEMBERS OF THE SUBCOMMITTEE FOR THE OPPORTUNITY TO TESTIFY BEFORE YOU THIS MORNING.

MY NAME IS MORRIS BECKER. I AM MAYOR OF EASTLAKE, OHIO, A CITY OF 22,000 PEOPLE IN NORTHEAST OHIO. I HAVE HAD THE HONOR OF HOLDING THIS POSITION FOR MORE THAN 13 YEARS.

THIS YEAR IT IS MY HONOR AND PRIVILEGE TO SERVE ALSO AS FIRST VICE PRESIDENT OF THE NORTHEAST OHIO AREAWIDE COORDINATING AGENCY, "NOACA", THE METROPOLITAN PLANNING ORGANIZATION FOR GREATER CLEVELAND. OUR ORGANIZATION IS BOTH OWNED BY, AND ADVOCATES THE INTERESTS OF, THE 2.2 MILLION PEOPLE RESIDING WITHIN THE 172 JURISDICTIONS OF GENERAL PURPOSE LOCAL GOVERNMENTS WITHIN THE FIVE NORTHEAST OHIO COUNTIES OF CUYAHOGA, GEAUGA, LAKE, LORAIN AND MEDINA.

NOACA IS NOT A BUREAUCRACY. IT IS GOVERNED BY ELECTED OFFICIALS - THE MAYORS, COUNCILMEN, TOWNSHIP TRUSTEES AND COUNTY COMMISSIONERS - OF THE COMMUNITIES IT REPRESENTS. ALL ITS DECISIONS ARE MADE IN PUBLIC, AS THE RESULT OF A THOROUGHLY OPEN PROCESS. WE ARE THE 23 U.S.C. 134 AGENCY, RESPONSIBLE FOR TRANSPORTATION PLANNING AND DEVELOPMENT OF THE TRANSPORTATION IMPROVEMENT PROGRAM FOR APPROXIMATELY ONE-FIFTH OF THE

POPULATION OF OHIO. IN THIS ROLE, IT IS UP TO US TO TRY TO MAKE TRANSPORTATION DOLLARS FROM ALL SOURCES STRETCH AS FAR AND AS WISELY AS POSSIBLE.

I COME BEFORE YOU TODAY, MR. CHAIRMAN, TO OFFER TESTIMONY CONCERNING VARIOUS ASPECTS OF THE LOCAL GOVERNMENT INFRASTRUCTURE FINANCING IMPROVEMENT ACT OF 1987. THIS BILL, INTRODUCED BY THE LATE, HONORABLE JAMES J. HOWARD, OFFERS A UNIQUE OPPORTUNITY FOR CONGRESS AND LOCAL GOVERNMENTS TO WORK TOGETHER IN MAINTAINING AND EXPANDING THE PUBLIC INFRASTRUCTURE FOR ECONOMIC DEVELOPMENT.

AS YOU KNOW, THE PRIVATE SECTOR IS ALWAYS A MAJOR FORCE IN ECONOMIC DEVELOPMENT. IN OFFERING THIS TESTIMONY, IT IS MY PLEASURE TO SPEAK ON BEHALF OF - NOT ONLY NOACA - BUT ALSO THE PRIVATE SECTOR. IN 1981 CLEVELAND FORMED A PUBLIC/PRIVATE PARTNERSHIP FOR INFRASTRUCTURE FINANCING WHICH IS NOW KNOWN AS "BUILD UP GREATER CLEVELAND". THIS GROUP, AND OUR CHAMBER OF COMMERCE, "THE GREATER CLEVELAND GROWTH ASSOCIATION", HAVE COOPERATED IN THE DEVELOPMENT OF THIS TESTIMONY AND FULLY SUPPORT THE POSITIONS PRESENTED HERE. TOGETHER WE OFFER THE FOLLOWING COMMENTS REGARDING HR 3807, IN ORDER TO SECURE A BETTER ECONOMIC FUTURE FOR OUR AREA, OUR STATE, AND THE NATION. WE ARE COMPILING WRITTEN DETAILED INFORMATION RELATED TO THE SPECIFIC PROVISIONS OF HR 3807. THESE RECORDS WILL PROVIDE SPECIFIC CASE HISTORIES AND EXPERIENTIAL DATA RELATED DIRECTLY TO THIS BILL.

NUMEROUS STUDIES SUPPORT THE FACT THAT PUBLIC INFRASTRUCTURE INVESTMENT PLAYS A CRUCIAL ROLE IN ECONOMIC DEVELOPMENT. MOREOVER, CERTAIN TYPES OF

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PUBLIC INFRASTRUCTURE INVESTMENT - ESPECIALLY TRANSPORTATION INVESTMENT - INFLUENCE ECONOMIC DEVELOPMENT TO A GREATER DEGREE THAN OTHER TYPES OF PUBLIC SPENDING. THEREFORE, IT IS IN THE NATIONAL INTEREST TO DEVELOP AN INFRASTRUCTURE INVESTMENT STRATEGY WHICH BEST SUPPORTS A SOUND NATIONAL ECONOMY.

THIS IS TRUE - OR PERHAPS ESPECIALLY TRUE - IN VIEW OF THE CURRENT BUDGET AND TRADE DEFICITS. I ASSURE YOU, LOCAL GOVERNMENTS HAVE BEEN HARD-PRESSED, OF LATE, TO MAINTAIN MERELY THE CURRENT LEVEL OF INFRASTRUCTURE, LET ALONE EMBARK ON ANY MAJOR IMPROVEMENT PROJECTS. AS HR 3807 STATES: GENERAL REVENUE SHARING HAS BEEN ELIMINATED, FEDERAL CATEGORICAL GRANTS HAVE BEEN REDUCED, AND THE CURRENT FEDERAL LAWS HAVE DISCOURAGED LOCAL GOVERNMENTS FROM PARTICIPATING IN THE BOND MARKETS.

IN 1987, ACCORDING TO CENSUS FIGURES, FEDERAL GRANTS-IN-AID TO LOCAL AND STATE GOVERNMENTS CONTINUED THEIR DOWNWARD TREND AND SHRANK ANOTHER 4.7%. AT THE SAME TIME, LOCAL AND STATE GOVERNMENTS HAD TO INVEST MORE OF THEIR OWN MONEY TO GET THESE FEDERAL DOLLARS. IN 1987, WE HAD TO PROVIDE 41 CENTS PER DOLLAR RECEIVED IN FEDERAL GRANTS. (AND THIS RATIO DOES NOT REFLECT ANY LOCAL OR STATE MONEY SPENT IN ADMINISTERING FEDERAL FUNDS.) THIS HAS, INEVITABLY, LED TO INCREASED TAXES AT LOCAL LEVELS. AS LOCAL GOVERNMENTS ARE RESPONSIBLE FOR MORE OF THE INFRASTRUCTURE AND MORE SOCIAL PROGRAMS, WHILE GETTING SIGNIFICANTLY LESS FEDERAL HELP, LOCAL FINANCING FOR INFRASTRUCTURE HAS INCREASED.

IN OHIO, FOR EXAMPLE, SINCE 1987, TO SUPPORT HIGHWAYS, LOCAL GOVERNMENTS IN OUR REGION IMPOSED HIGHER VEHICLE LICENSE FEES. OUR STATE GOVERNMENT

INCREASED GASOLINE TAXES, AND THE VOTERS OF THE STATE OF OHIO APPROVED A TEN-YEAR $1.2 BILLION INFRASTRUCTURE BOND ISSUE. ALL THESE ACTIONS WERE NECESSARY JUST TO SUPPORT ATTEMPTS TO MAINTAIN EXISTING INFRASTRUCTURE.

EVEN WITH THIS ADDITIONAL TAX SUPPORT, IT IS DOUBTFUL THAT WE CAN MAINTAIN - IN SAFE OPERATING CONDITION - OUR EXISTING TRANSPORTATION FACILITIES.

IN A STUDY JUST COMPLETED BY NOACA, IT WAS DETERMINED THAT THE PRICE TAG FOR NECESSARY BRIDGE REPAIRS, REHABILITATIONS, AND REPLACEMENTS - JUST FOR THE FIVE-COUNTY GREATER CLEVELAND AREA OF NORTHEAST OHIO - IS APPROXIMATELY $1.57 BILLION. A COPY OF THIS REPORT IS SUBMITTED FOR YOUR USE.

THIS $1.57 BILLION NEEDED FOR BRIDGES IS OVER 30 PERCENT MORE THAN WILL BE AVAILABLE FOR THE ENTIRE STATE OF OHIO OVER A TEN-YEAR PERIOD FROM THE NEW VOTER-APPROVED BOND ISSUE. AT THE SAME TIME, ONLY $346 MILLION IN FEDERAL-AID FOR THIS BRIDGE REPAIR WORK - JUST 22 PERCENT OF THE FUNDS NEEDED TO KEEP EXISTING BRIDGES OPEN AND OPERATING SAFELY - IS AVAILABLE TO US FROM THE HIGHWAY TRUST FUND.

SADLY, OUR EXPERIENCE IN NORTHEAST OHIO IS THE RULE RATHER THAN THE EXCEPTION.

SO HR 3807 WILL OFFER LOCAL GOVERNMENTS ADDITIONAL MEANS TO MAKE SUCH PROBLEMS A BIT MORE MANAGEABLE. THE TECHNICAL ASSISTANCE AND THE BIENNIAL REPORTS THAT THE BILL PROPOSES WILL OFFER MEDIUM AND SMALL-SIZED

COMMUNITIES A GREAT DEAL OF VERY USEFUL INFORMATION. ALSO, THE LOOSENING OF THE RULES FOR LOCAL GOVERNMENTS WITH REGARD TO ARBITRAGE AND PRIVATE-ACTIVITY BONDS WILL HELP TO REMOVE THE CURRENT DISINCENTIVES FOR ECONOMIC DEVELOPMENT BASED ON GOVERNMENTS' PARTICIPATION IN THE BOND MARKETS.

THESE ARE IMPORTANT, SUPPORTIVE STEPS TOWARD EFFECTIVE AND FEASIBLE ECONOMIC DEVELOPMENT. WE APPLAUD AND ENDORSE THEM. AT THE SAME TIME, IT IS MANDATORY THAT THE FEASIBILITY OF BONDS AS A MAJOR SOURCE OF FINANCING FOR INFRASTRUCTURE NOT BE OVERESTIMATED.

FOR ANY ELECTED OFFICIAL TO PROPOSE AND ENDORSE PUBLIC BONDS FOR INFRASTRUCTURE, SUCH ACTION MUST BE BOTH NECESSARY AND APPROPRIATE. BY THAT, I MEAN THAT TAXPAYERS WILL, AS THEY ALWAYS HAVE, SUPPORT WHAT IS BOTH NEEDED AND MAKES SENSE. NEED ALONE IS NOT ENOUGH.

CLEARLY, GIVEN THE EXAMPLE OF BRIDGE NEEDS IN ONE PART OF OHIO, EVEN THE MOST URGENT INFRASTRUCTURE REPAIRS ARE WELL BEYOND THE MEANS OF LOCAL AND STATE GOVERNMENTS, AND EXISTING FEDERAL-AID. AND THE SHORTFALL IS FAR BEYOND WHAT CAN BE RAISED THROUGH BOND ISSUES.

DETAILS ON WHAT TYPES OF GOVERNMENTAL UNITS HAVE MOST CONSISTENTLY CHOSEN BOND FINANCING, AND THE AMOUNTS RAISED AND EXPENDED FOR INFRASTRUCTURE AND ECONOMIC DEVELOPMENT ARE BEING COLLECTED NOW. THESE WILL BE FORWARDED TO YOU AS SOON AS POSSIBLE.

SOME, BUT FAR FROM A MAJORITY, OF THE SUBSTATE UNITS OF GOVERNMENT IN OHIO HAVE CHOSEN BONDS AS A MECHANISM TO ADDRESS A PORTION OF THEIR INFRASTRUCTURE NEEDS.

THERE ARE SOUND REASONS WHY BONDS ARE NOT USED MORE OFTEN.

FOR LOCAL BOND FINANCING OF INFRASTRUCTURE TO MAKE SENSE, SEVERAL CHANGES, OTHER CHANGES IN EXISTING LAW, IN ADDITION TO THE PROVISION OF HR 3807, ARE NECESSARY.

THEREFORE, WE RESPECTFULLY OFFER THE FOLLOWING SUGGESTIONS:

FIRST, MONIES IN THE HIGHWAY TRUST FUND SHOULD BE FULLY DISTRIBUTED WITHOUT CONTINUING THE RECORD HIGH BALANCES THAT CURRENTLY EXIST. THIS MAY MEAN SETTING HIGHER OBLIGATION LIMITS OR REMOVAL OF SOME CATEGORICAL OBLIGATION CEILINGS, OR BOTH. THE UNLOCKING OF THESE "USER" FEES IS THE ONLY WAY THAT MEANINGFUL NEW CONSTRUCTION AND MAJOR RECONSTRUCTION CAN BE UNDERTAKEN. IT IS THE ONLY MEANS OF GETTING OUR GAS TAX DOLLARS TO CONTRIBUTE IN ANY SUBSTANTIAL WAY TO ECONOMIC DEVELOPMENT.

LOCAL AND STATE GOVERNMENTS ARE ONLY BARELY KEEPING UP WITH REPAIRS TO THE BASIC HIGHWAY SYSTEM NOW. THE FEDERAL GAS TAX IS NOT AVAILABLE TO HELP THEM DO THIS TO THE EXTENT FORESEEN IN 1982 - AND VERY LITTLE, IF ANY, OF THE FEDERAL GAS TAX IS REALLY AVAILABLE FOR ECONOMIC DEVELOPMENT. DOES IT MAKE SENSE FOR LOCAL GOVERNMENTS TO PLACE THEMSELVES AND THEIR CITIZENS IN LONG-TERM DEBT TO FUND CONSTRUCTION THEY ARE ALREADY PAYING FOR - AND THOUGHT THEY WOULD GET - WHEN THE FEDERAL GAS TAX WAS MORE THAN DOUBLED?

WE UNDERSTAND THAT ON THIS SUBJECT WE ARE "PREACHING TO THE CHOIR". WE ALSO UNDERSTAND THAT THE LIKELIHOOD OF GETTING FULL RELEASE OF THE HIGHWAY TRUST FUND IN THE NEAR FUTURE IS NOT GREAT. BUT YOU HAVE OUR WHOLE-HEARTED SUPPORT IN YOUR EFFORTS. WE URGE YOU TO KEEP THE PRESSURE ON.

SECOND, THE ROLE OF THE FEDERAL GOVERNMENT IN INFRASTRUCTURE INVESTMENT AND ECONOMIC GROWTH SHOULD BE RE-EXAMINED FROM A MUCH BROADER PERSPECTIVE. REGIONS THAT PRESENTLY OR POTENTIALLY CAN CONTRIBUTE TO A POSITIVE TRADE BALANCE SHOULD BE TARGETTED FOR MORE OF THE FEDERAL SPENDING ON INFRASTRUCTURE.

IN SOME CASES, SUCH AS THE CLEVELAND METROPOLITAN AREA, SUCH EXPORT-INCENTIVE INVESTMENT COULD SIMULTANEOUSLY BE LINKED TO AIR QUALITY IMPROVEMENTS AND PUBLIC/PRIVATE PROJECTS THAT CREATE PERMANENT JOBS. OHIO HAS THE LARGEST EXPORT TRADE BALANCE WITH CANADA OF ANY STATE IN THE UNION. BUT CURRENT FEDERAL INFRASTRUCTURE INVESTMENT POLICIES PUT US AT THE BOTTOM OF THE LIST FOR HIGHWAY FUNDING. CURRENT LAW ACTUALLY WORKS AGAINST CORRECTION OF THE TRADE IMBALANCE AND JOB CREATION IN MANY STATES. OHIO IS, BY NO MEANS, THE ONLY STATE IN THIS SITUATION.

DOES IT MAKE SENSE FOR A LOCAL GOVERNMENT TO ISSUE BONDS IN AN ATTEMPT TO CORRECT - OR COMPENSATE FOR - MIXED MESSAGES ENCOURAGING EXPORTS, ENCOURAGING JOB CREATION, BUT DISCOURAGING REPAIR AND EXPANSION OF THE INFRASTRUCTURE WHICH MOVES FREIGHT, SERVICES, AND PEOPLE?

THIRD, IN ORDER TO PROVIDE GREATER ACCESS TO NEEDED FUNDS, THE RECEIPT OF DISCRETIONARY AND EMERGENCY RELIEF FUNDS SHOULD NOT REDUCE THE FEDERAL-AID HIGHWAY MINIMUM ALLOCATION APPORTIONMENT TO ANY STATE. FOR EXAMPLE, THE 17 STATES PRESENTLY ELIGIBLE FOR MINIMUM ALLOCATION FUNDS GAIN ABSOLUTELY NOTHING FROM RECEIVING DISCRETIONARY OR EMERGENCY HIGHWAY FUNDING, BECAUSE EACH DOLLAR RECEIVED FROM THESE SOURCES MERELY IS DEDUCTED FROM THEIR MINIMUM ALLOCATION APPORTIONMENT. THEY LOSE A DOLLAR OF M.A. FUNDS FOR EACH DOLLAR OF DISCRETIONARY BRIDGE OR EMERGENCY FUNDS.

RECALL, IF YOU WILL, THAT THESE ARE THE SAME STATES THAT RECEIVE THE LOWEST LEGAL RETURN ON THEIR CONTRIBUTIONS TO THE HIGHWAY TRUST FUND. BUT THESE SAME 17 STATES CONTAIN 47 PERCENT OF ALL DEFICIENT BRIDGES ON THE FEDERAL-AID SYSTEM! SO EXISTING LAW ACTS AS A MAJOR DISINCENTIVE TO ECONOMIC DEVELOPMENT IN AREAS WHICH CONTAIN ALMOST HALF THE DEFICIENT BRIDGES IN THE U.S. DOES IT MAKE SENSE FOR LOCAL GOVERNMENTS TO ISSUE BONDS TO REPAIR FACILITIES THAT ARE ROUTINELY REPAIRED WITH FEDERAL MONEY IN THE OTHER 33 STATES?

FOURTH, AND FINALLY, DESIGNATION OF THE FEDERAL-AID HIGHWAY SYSTEM SHOULD BE RE-EXAMINED. OUTDATED FEDERAL-AID CLASSIFICATION SYSTEMS SHOULD BE UPDATED TO PROVIDE FOR EFFICIENT DISTRIBUTION OF FUNDS IN THE 1980'S, NOT THE 1950'S. HIGHWAY FUNDS ARE DISTRIBUTED IN MANY STATES BASED ON THE SYSTEM OF HIGHWAYS DESIGNATED AS MOST IMPORTANT TO THE ECONOMY OF TWENTY OR THIRTY YEARS AGO. THE CURRENT SYSTEM PENALIZES FORESIGHT AND REWARDS HINDSIGHT.

WE IN OHIO BUILT THE OHIO TURNPIKE - A 241-MILE STRETCH OF LIMITED ACCESS HIGHWAY WHICH WE PAID FOR WITH BONDS AND CONTINUE TO REPAIR WITH BONDS. CURRENT LAW DOESN'T GRANT US ENOUGH FEDERAL INTERSTATE REPAIR FUNDS TO TAKE TOLLS OFF, EVEN THOUGH THIS IS ONE OF THE MOST HEAVILY TRAVELLED SECTIONS OF THE U.S. INTERSTATE SYSTEM. YOU WOULDN'T GET MUCH SUPPORT FOR BOND-FINANCED CONSTRUCTION OF OHIO SEGMENTS OF I-76 AND I-80 - IT WOULDN'T MAKE SENSE. THE OHIO TURNPIKE ISN'T EVEN ELIGIBLE FOR FEDERAL REPAIR FUNDS, AND IT HAS BEEN A PART OF THE INTERSTATE SYSTEM SINCE 1964.

RATHER THAN EXPLORING PROPOSALS THAT REDUCE THE FEDERAL-AID SYSTEM AND/OR THE FEDERAL ROLE, PROPOSALS SHOULD BE CONSIDERED WHICH TIE THE CLASSIFICATION OF FEDERAL-AID SYSTEMS TO MODERN DEMOGRAPHIC AND TRAVEL PATTERNS AND MODERN ECONOMIC DEVELOPMENT CRITERIA.

THANK YOU FOR THE OPPORTUNITY TO OFFER OUR COMMENTS AND SUGGESTIONS. HR 3807 PRESENTS US WITH AN OCCASION TO DYNAMICALLY INFLUENCE ECONOMIC GROWTH IN OUR NATION. WE CAN, THROUGH WORKING TOGETHER, IMPROVE BOTH THE INFRASTRUCTURE AND THE ECONOMY. HR 3807 IS AN IMPORTANT FIRST STEP. I AM PLEASED TO OFFER THE ASSISTANCE OF NOACA, THE GREATER CLEVELAND GROWTH ASSOCIATION, AND BUILD-UP GREATER CLEVELAND TO THIS COMMITTEE IN ITS EFFORTS TO ENACT ITS PROVISIONS TO BUILD UPON ANY OF THESE CONCEPTS OFFERED HERE.

County Engineers Association of Ohio

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August 5, 1988

Subcommittee on Economic Development
of the Committee on Public Works and Transportation
U.S. House of Representatives

Re: HR 3807

Dear Mr. Chairman:

The County Engineer's Association of Ohio represents all eighty-eight elected County Engineers in the State of Ohio and exists to raise the technical and non-technical standards of service rendered to the general public by the County Engineers and their employees.

Our Association has for years been concerned with the deteriorating condition of the infrastructure within the State of Ohio. Old age and lack of adequate funding for maintenance and replacement have caught up with our highways, bridges, storm sewers, flood control facilities, sanitary sewers, water lines, wastewater and water in plants.

Our engineers are faced with potential catastrophes on a daily basis due to the funding shortage in these areas. The County Engineers in Ohio are responsible for over 27,000 bridges and almost 30,000 miles of highway. In addition, counties are responsible for many thousands of miles of sanitary sewer and water lines. These facilities must safely serve the millions of people in Ohio on a daily basis.

The requirements for the performance levels of these services are becoming ever more stringent. Many of the standards that are set at a national level by Congress or by Federal Departments add significantly to the local needs. Not too many years ago Congress passed a law that raised the load limits on trucks. This law has a significant negative impact on local roads and bridges. The design life for roads and bridges is directly related to truck loading and when these loads were increased the anticipated life of roads and bridges was reduced. As a result the need for local infrastructure dollars was increased.

The County Engineer's Association of Ohio is dedicated to working towards a resolution to the problems relating to the existing infrastructure system in Ohio. To that end we will endorse and support House Resolution 3807. We would, however, request that under section (c) on page 5 that public bridges, public flood control structures, public storm water collection and storage systems be included within the definition of a Public Works Facility.

The findings, contained in Section 2 of H.R. 3807, we feel begin to address the current status of the infrastructure issue. The statement of findings should go on to add that in these United States there is now a crisis related to the condition of our infrastructure. The facilities that exist now were built many years ago and are reaching the upper limit of there useful life. The infrastructure within our townships, villages, cities and counties jurisdictions must be the number one priority, for all levels of government. How can any unit of government provide the necessary basic services without an adequate transportation system, without an adequate supply of water or without the ability to adequately dispose of sewerage?

These items are the ones addressed everyday by the County Engineers and all other local governmental units within Ohio.

The available local funds are dramatically insufficient when compared to the level of service we should be providing to our citizens. As a part of our Associations public education campaign of Ohio's infrastructure problems, we provided information gathered from a survey of the County Engineers in Ohio. This survey indicated that the County Engineers needed to double and in some cases, triple the funds that currently are available for their operations. Obviously, Ohio's situation is not unique in these United States. We only have to read the newspaper to become aware of bridge disasters around the country, or of water shortages, or problems with wastes.

Any type of legislative assistance towards improving the ability of local government to address the current and future needs to rehabilitate or replace our existing infrastructure will be supported and endorsed by our Association.

House Resolution 3807 will assist local government in utilizing tax exempt bonds and will increase the amount of these bonds available. The result will be to lower the total cost for locally bonded projects.

The County Engineer's Association of Ohio would like to thank you for this opportunity to provide input on this matter and would offer to provide other information on this resolution or any other that deals with the critical situation of our infrastructure.

Sincerely,

Glenn W. Sprowls

Glenn W. Sprowls
Executive Director

cc: Gary Durbin, President
Lowell McCarty
Robert Morrison
Congressman McEwen

GWS/djb

Mr. PAYNE. There being no further business, the subcommittee stands adjourned.

[Whereupon, at 2:06 p.m., the subcommittee was adjourned.]

ADDITIONS TO THE RECORD

Statement of

The Associated General Contractors of America

on

H.R. 3807

The Local Government Infrastructure Financing Act

August 18, 1988

AGC is:

- More than 32,500 firms including 8,000 of America's leading general contracting firms responsible for the employment of 3,400,000-plus employees;
- 104 chapters nationwide;
- More than 80% of America's contract construction of commercial buildings, highways, industrial, and municipal-utilities facilities;
- Over $100 billion of construction volume annually.

The Associated General Contractors of America fully supports H.R. 3807, the Local Government Infrastructure Financing Act. This legislation would provide much-needed relief from some of the harshest restrictions enacted in the Tax Reform Act of 1986, the arbitrage rebate rules and the private activity bond rules, to local governments that are small issuers of tax-exempt bonds.

The legislation being considered by the Subcommittee, H.R. 3807, would exempt from the arbitrage rebate rules governmental units which issue $25 million or less of tax-exempt bonds in a calendar year. Further, the legislation would exempt these small issuers from the 10 percent private activity restriction, and allow these small issuers to allow up to 25 percent private participation. In addition, the legislation would require the Secretary of Commerce to study public works financing practices, and report back to Congress every two years.

The Associated General Contractors of America urges the Congress to act as expeditiously as possible to aid local governments in their efforts to finance much-needed infrastructure. Immediate action is necessary for several reasons:

- The federal government has reduced its commitment to public works funding in response to federal budget pressures. With the end of the federal revenue sharing program, unspent balances in the highway and airport trust funds, and lower authorization and obligation levels in many public works programs than are needed, the federal government has clearly indicated to state and local governments that their

share of the public works financing burden must be increased.

- The Tax Reform Act of 1986, without in-depth consideration by Congressional tax-writing committees of the complex nature of tax-exempt bond funding and its role in public works financing, drastically reduced both the availability and flexibility of bond funding.
- The National League of Cities, in their 1988 annual fiscal survey, reports that 44 percent of respondents indicated that they had cut capital or infrastructure expenditures during the past year. This response is in line with the much smaller volume of bond issuances going to market last year.
- Infrastructure, the sum total of many diverse public works projects in thousands of states, localities, and governmental jurisdictions, is a vital prerequisite for economic growth and prosperity. Economic studies done at the Federal Reserve Bank of Chicago among others have shown a clear economic link between investment in public works capital and the rate at which economic growth occurs. Tax provisions which restrict the ability of local governments to finance these needed public works projects, simply to supplement the federal government's cash flow, should be rejected as short-sighted and counterproductive.
- Examples abound to illustrate the illogic of current law in both the arbitrage rebate area and the private activity restrictions. The arbitrage rebate rules would require

proceeds of any bond issuances to be spent on the project within six months of receipt. The complexities of the construction process, including the desirability of open competitive bidding to ensure that construction is done most cost-effectively, make it extraordinarily difficult for cities to spend the bond proceeds within six months. AGC believes that the prior three-year requirement was much more reasonable.

The new 10 percent private activity restriction is limiting both the flexibility of local governments to design projects in the best possible way, but is at risk of being taken to new levels of absurdity. Indications that a highway interchange might not be eligible for tax-exempt financing if more than 10 percent of the vehicles that will use it are traveling to or from a development, factory or business -- either as employees or customers -- places totally unacceptable restrictions on public works designers and governments.

AGC remains opposed to these restrictions on infrastructure financing, which is viewed by this Association as a keystone for future economic progress. AGC stands firmly behind the Committee's efforts to begin rolling back these unwarranted intrusions into the financing mechanisms of local governments, and appreciates the opportunity to offer these comments.

FGIC Corporation
175 Water Street
New York, New York 10038
Telephone: 212 607-3000
(800) 352-0001

The Financial Guaranty Company

FGIC

August 23, 1988

Mr. Carl Lorenz
Staff Director and Counsel
Subcommittee on Economic Development
of the Committee on Public Works & Transportation
U.S. House of Representatives
B 376 Rayburn House Office Building
Washington, DC 20515

Re: HR 3807

Dear Mr. Lorenz:

FGIC Corporation, through its subsidiary Financial Guaranty Insurance Company, is one of four major municipal bond insurance companies guaranteeing investors the timely payment of principal and interest on municipal bonds in the event of default. Since 1971, our industry has insured approximately $150 billion in par value of new issue municipal bonds, representing more than $390 billion in principal and interest.

In our ongoing credit review process, we at FGIC regularly examine the financial and economic status of the municipal entities whose bonds we insure, as well as the state of existing public projects within these municipalities. As chairman of FGIC Corporation, I am in a unique position to observe the state of our nation's infrastructure.

I am writing in support of the proposed bill to amend two provisions of the Tax Reform Act of 1986 concerning arbitrage rebate regulations and private purpose bond activity, which would provide more lenient treatment for small issuers of tax-exempt bonds.

Under the present law, private activity bond issuance is restricted to $5 million per issuer, and the arbitrage regulations require a rebate of all but 10 percent of excess bond proceeds to the U.S. Treasurer. As a result, financing costs have risen, creating greater burdens for issuers.

The Tax Reform Act of 1986, together with reduced federal aid, has contributed to the neglect of necessary construction and repairs of the municipal infrastructure. This lack of investment in public works - highways, bridges, water and sewage systems - represents a mortgage on our future.

FGIC Corporation

Mr. Carl Lorenz

One of the goals of the Act was to prevent municipalities from abusing arbitrage regulations and misusing bond proceeds. However, this sweeping legislation has penalized local governments by restricting a variety of financing techniques, not just those that enabled issuers to benefit from excessive profits generated by tax-exempt dollars.

Meanwhile, infrastructure deterioration has reached critical levels across the nation. Near Albany, New York the interstate highway bridge over Schoharie Creek collapsed in April 1987 killing ten motorists. Since then, four similar spans have fallen. In Los Angeles, corrosion has already forced the replacement of sewage pipes that were designed to last another 100 years. Over the next five years, Illinois will experience a shortfall of $4.9 billion for needed highway repairs.

As these examples illustrate, the present levels of decay already pose a significant threat to public safety and quality of life. Continued decay will threaten our economic vitality. Without an intensified commitment to public reinvestment, a majority of the nation's communities will be in jeopardy. The passing of HR 3807 will enhance the ability of municipalities to finance their infrastructure projects.

HR 3807 is one of many flexible financing alternatives that Congress should consider to alleviate the burdens that have fallen on municipalities.

Throughout the committtee's deliberations, on HR 3807 or on other matters, I urge you to keep in mind the need to provide ways for municipalities to maintain, and where needed, rebuild, the foundations upon which our national economic well-being depends.

Sincerely,

Gerald L. Friedman
Chairman

GLF:ml

**National
Association of
Towns and Townships**

July 28, 1988

Mr. Carl Lorenz
Director, Economic Development
House Committee on Public Works and Transportation
2165 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Lorenz:

We were pleased to see that you have scheduled hearings on Mr. Howard's local infrastructure bill, H.R. 3807. The National Association of Towns and Townships (NATaT) is very interested in this issue, as you might imagine, and we regret that the short time frame does not permit us to participate in what I know will be a very valuable hearing. We would like, however, to reiterate a few key points -- which were mentioned in our letter of June 29, 1988 -- in support of H.R. 3807, in the hopes that the concerns of the very smallest communities across America might be addressed.

It might be helpful for you to know that of the nearly 40,000 general-purpose governments in the United States, 72 percent have populations of less than 3,000 people, and fully half have populations under 1,000. We are essentially a nation of small towns. For the most part, these small communities, run primarily by volunteer local officials, have very small budgets; yet they have major responsibilities for maintenance and repair of infrastructure such as roads and bridges. As a result, the more than 13,000 towns, townships and small communities which are NATaT members are very interested in seeing initiatives such as H.R. 3807 succeed.

We do have several suggestions which I hope you will consider as this legislation evolves:

1. **Technical assistance to local governments on how to finance public works projects and issue tax exempt bonds is crucial.** In this context it is helpful to remember that the average governments in this country is about the same size as the average Washington, D.C. condominium association -- and it is run on the same basis -- by volunteers who donate their time apart from their regular jobs. As a result, although they are clearly capable administrators, they have no special expertise and need guidance in technical areas, such as the issuance of public bonds.

2. Local officials need to know that help is available. **We urge that**

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Congress include in H.R. 3807 a requirement for a significant outreach program to ensure that the smallest of communities benefit from this technical assistance program.

3. In order for small governments to benefit from this legislation, **the definition of "public works programs" needs to be expanded.** The water line systems in many small communities, for example, may represent 80 percent of the cost; in rural areas you may have to run pipes 80-90 feet between houses as opposed to every 20-30 feet on a street like Wilson Boulevard in Arlington. Thus, the highest public works costs can be collection and water line systems, as opposed to the actual water or wastewater facility.

4. And finally, there are the bridges. As you are probably aware, local bridges are in a very sad state of disrepair -- many are posted and some are closed entirely. This results not only in inconvenience for local residents, but in added transportation costs for carriers who must detour many miles on each trip. In fact, according to the Pennsylvania Department of Transportation, Pennsylvania steel companies spent a million dollars a year detouring around posted bridges until the Agri-access and Commercial-access systems were adopted in that state. **If local bridges could be added to the "public works" definition, the nation as a whole would benefit.**

We would certainly appreciate the opportunity to participate in the dialogue on this legislation and other legislation moving through the Committee which affects small governments. I believe that NATaT is presently on the Committee mailing list, but if there is a subcommittee list as well, we would like to be included.

Please feel free to contact us at any time if you feel we can be helpful.

Wish best wishes.

Sincerely,

Ann Cole

Ann Cole
Director of Federal Affairs

TESTIMONY TO

SUBCOMMITTEE ON ECONOMIC DEVELOPMENT

OF THE

HOUSE COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

RELATING TO

HR 3807: LOCAL GOVERNMENT INFRASTRUCTURE

FINANCING IMPROVEMENT ACT OF 1987

BY

WALTER T. OLSON, DIRECTOR

BUILD UP GREATER CLEVELAND

AUGUST 11, 1988

GREATER CLEVELAND GROWTH ASSOCIATION
GREATER CLEVELAND GROWTH ASSOCIATION
GREATER CLEVELAND GROWTH ASSOCIATION

TESTIMONY TO
SUBCOMMITTEE ON ECONOMIC DEVELOPMENT
OF THE
HOUSE COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

We are most appreciative of the opportunity provided by the Subcommittee on Economic Development of the House Committee on Public Works and Transportation for us to offer testimony on HR3807, the Local Government of Infrastructure Financing Act of 1987.

This testimony is presented on behalf of the Build Up Greater Cleveland program by the program director, Walter T. Olson. The Build Up Greater Cleveland program is a public-private partnership seeking to finance infrastructure rehabilitation throughout Cuyahoga County, Ohio. Participants include the County Commissioners, County Engineer, the City of Cleveland, three mayors from the Mayors and Managers Association that represents 56 cities and villages, the Regional Transit Authority, the Northeast Ohio Regional Sewer District, the Northeast Ohio Areawide Coordinating Agency and private sector members from the Greater Cleveland Growth Association (Chamber of Commerce). Additional views for this testimony were elicited from several mayors, finance directors, bond counsel and an investment banker experienced in public finance.

Much of what we would tell the Subcommittee about HR3807 and the issues behind it has been ably presented by Mayor Morris Becker of Eastlake, Ohio, the First Vice President of the Northeast Ohio Areawide Coordinating Agency, NOACA, with whom we work closely. We agree that this bill and the interests of your subcommittee afford

opportunity for Congress and local governments to work together in maintaining and expanding the public infrastructure for economic development. The unanimity of opinion encountered locally is that provisions like those in HR3807 are needed to lighten the burden on local governments as they try to maintain the well-being of their communities and to encourage business, industry and retention and creation of jobs. The similarity of views expressed to me suggests that these views are widely held in our nation.

We agree with the findings expressed in Section 2 of the bill, and we note especially the cumbersome and expensive aspects of recent federal law and rules on arbitrage rebate and on private activity bonds. We believe that the special rules proposed in Section 5 of the bill are valuable for several reasons.

Municipal issuers need <u>flexibility for the orderly management of money</u>. The proceeds of local tax-exempt bonds are often required to match state or federal funds, and thus there are time-tables to be met with respect to the amounts involved. Other constraints embrace the vagaries of carrying out projects: weather, strikes, cost overruns, etc. The ability to bank or invest funds, to pay contractors in an orderly way, to gain interest as a cushion against overruns, or to use extra proceeds and interest against the next similar capital need are elements of flexibility that are required for the orderly management of money. HR3807 would restore such flexibility, at least to small issuers. The existing arbitrage limitations should be sufficient, without the added punitive impact of rebate requirements, to avoid abuses in these cases.

Municipal issuers need flexibility to help achieve societal goals. A 10% limitation on private uses of a public investment can easily be seen to prevent veterans, or "golden agers", or other such groups from servicing a part of a building; e.g., a cafeteria, if such employment of the facility fails the 10% test. It becomes difficult to provide infrastructure to retain or attract industry, particularly in a "one company town"; the dreadful consequences of losing a company in such circumstances are well known. Even a large city like Cleveland can show examples of urban redevelopment that could not have been financed as they were under present rules. Moving the test for private activity on tax-free municipal bonds from 10% to 25% is a step in the right direction.

Municipal issuers need freedom from uncertainty and financial risk. The consequences of an error in issuing tax free bonds can be severe. Actions taken in good faith can end in damage if a bond issue becomes taxable, and the new provisions with respect to arbitrage rebate, which are so complex that the Treasury Department still has not produced regulations governing them, are especially difficult to deal with. Taxes from day of issue plus interest and penalties can be required of the bondholders in the case of an error. They can be expected to obtain redress from the issuer. The obvious impact is to raise the cost of issuance to insure against such possibilities.

Municipal issuers need to be spared the time and expense of engaging legal and financial experts in tax-free bonds to review the very

complex set of laws and rules governing this aspect of tax-exempt financing. A small community may spend several thousand dollars--a lot of them--to find out what is owed the federal government, or even that nothing is owed.

There is a real concern that the administrative difficulties of dealing with complex law and rules and the financial cost and risk involved are sufficiently intimidating and chilling as to inhibit a vigorous search for funds to match those of state and federal governments in the necessary joint effort to rebuild and enhance the public capital plant that supports the wealth-producing capability of the nation. We endorse the intent of HR3807 as a helpful step. We also would encourage earnest attention and vigorous action by the Subcommittee and the U.S. Congress to develop and pursue a national strategy for investment in infrastructure that will effectively use the vast resources of the federal government along with state and local governments as true partners.

Thank you for this opportunity for comments and suggestions on HR3807. Build Up Greater Cleveland, the Greater Cleveland Growth Association and NOACA offer to assist in your efforts to help economic development in our nation.

Submitted by:
Walter T. Olson, Director
Build Up Greater Cleveland
Greater Cleveland Growth Association
690 Huntington Building
Cleveland, Ohio 44115
(216) 621-3300

WTO:vw
8/11/88

Testimony

of

Public Securities Association

before the

Subcommittee on Economic Development
Committee on Public Works and Transportation
U.S. House of Representatives

August 10, 1988

The Public Securities Association (PSA) appreciates the opportunity to submit testimony on H.R 3807, "The Small Issuer Relief Act." PSA is the international trade organization of banks, dealers, and brokers that underwrite, trade and sell state and local government securities, mortgage-backed securities, money market securities, and U.S. government and federal agency securities. PSA's member firms collectively account for approximately 95% of the nation's municipal securities underwriting and trading activity. As the representative of market professionals who serve state and local governments in financial markets, PSA is in a position to appreciate the importance of H.R. 3807. PSA enthusiastically supports the legislation.

The Tax Reform Act of 1986 did serious harm to state and local finance. The Act set up a complex machinery of regulation and classification that has reduced the scope and increased the cost of tax-exempt finance. Unfortunately, this occurs at a time when the need for tax-exempt finance is increasing dramatically. The federal government has scaled back its aid to state and local governments and eliminated general revenue sharing, forcing states to rely more and more on their own resources. At the same time, federal policies designed to leave more matters to lower levels of government, have forced states and localities to take on increasing responsibilities. The most drastically affected victims of this policy trend have been small municipalities. Furthermore, much of the responsibility for addressing the huge infrastructure needs that face the country will ultimately be borne by state and local government. Concern over the ability of state and local governments to adequately finance infrastructure improvements has led a number of observers to question the wisdom of the Tax Reform Act of 1986 as it pertains to municipal finance. In its final report, for example, the National Council of Public Works Improvement included a call for the "removal of unwarranted limits on... tax-exempt financing".

PSA believes that, ultimately, the federal government will be forced to reexamine its policy toward tax-exempt municipal bonds, particularly as it relates to infrastructure financing. H.R. 3807 is an important step in this direction. Two of the most burdensome and restrictive provisions of the Tax Reform Act of 1986 were the arbitrage rebate requirement and the tightening of the private use limits on governmental municipal bonds. H.R. 3807 would provide substantial relief in each of these areas to small, local governments that could benefit greatly from less burdensome regulation. The bill would only affect localities that issue $25 million or less in tax-exempt, governmental bonds in a year.

With respect to arbitrage rebate, the Tax Reform Act (TRA) requires, with very few exceptions, that state and local bond issuers rebate all arbitrage profits to the federal government unless all bond proceeds are expended within six months of bond issuance. Bond issuers are able to earn arbitrage income because

tax-exempt yields are lower than taxable yields for securities of comparable risk and maturity; issuers borrow at the lower tax-exempt rate and invest the proceeds in higher yielding taxable securities. Prior to the TRA, issuers were able to use arbitrage earnings to reduce the cost of their projects for a temporary period (generally three years) while project construction was being completed and some bond proceeds were idle. The TRA forces issuers to turn over all arbitrage earnings to the Federal Treasury unless bond proceeds are spent within six months of issuance, a time period far too short to complete a major infrastructure project. Besides eliminating the ability to use arbitrage to reduce the cost of projects, the arbitrage rebate requirement also imposes huge administrative costs on state and local governments, who must painstakingly track the yields earned on bond proceeds according to formulae devised by the Department of the Treasury in order to verify that no arbitrage rebate is required. The Government Finance Officers Association (GFOA) estimates that the total arbitrage rebate compliance costs for state and local issuers could exceed $1.1 billion in the first five years.

Clearly, issuers in the worst position to handle the expense and burden of arbitrage rebate compliance are small local governments. Under current law, localities that issue $5 million or less in tax-exempt governmental bonds in a year are exempted from the arbitrage rebate requirement for their governmental (i.e., non "private activity") bond issues. H.R. 3807 would extend this exemption to localities that issue $25 million or less in a year. This would be welcome relief to many small localities across the country, but would affect only a relatively small percentage of total bond volume and hence would have a relatively small revenue effect. According to GFOA data for 1987, raising the arbitrage rebate exemption to $25 million could assist nearly 90% of tax-exempt bond issues while affecting only 27% of total bond proceed volume.

In addition to arbitrage, H.R 3807 would also address the tightening of the private use rules under the TRA. Prior to the TRA, up to 25% of the proceeds of a bond issue could be used by private businesses without the tax-exemption of the bonds being called into question. The TRA lowered this percentage to 10%. Hence, under current law, if more than 10% of the proceeds are used by a private business, and more than 10% of the interest payments on the bonds is secured by private funds, a bond issue is labeled "private activity" and must be issued as a taxable security unless it falls under one of the exceptions in the tax code. H.R. 3807 would return the private use percentage to 25% for localities that issue no more than $25 million in governmental tax-exempt bonds in a year.

The change in the private use tests enacted in 1986 have hindered the financing of important public projects. In general, there seems to be some confusion of <u>private use</u> with the ultimate <u>public purpose</u> of the project. If a locality builds a government building or a school, for example, and wishes to contract cafeteria service to a private business, it could easily run afoul of the private use tests. Small localities that house large

private business operations can find themselves in trouble when they want to construct infrastructure or utility projects for the benefit of the entire community. The businesses may account for more than 10% of the ultimate use of the project and may pay some access fee, causing the entire bond issue to be ruled "private activity." Use by the federal government also constitutes "private use." In at least one case, a town wishing to build a new sewage system was hindered by the private use rules when it was determined that a nearby Air Force base would account for more than 10% of the sewage processed.

Clearly, if small localities are to gather the resources to meet their mounting public infrastructure needs, the federal government must remove unwarranted obstacles to tax-exempt finance. Tax-exempt bonds are not a tax loophole, but an important financing tool that allows public investment in capital projects which benefit entire communities, and indeed, in many cases, the entire nation. Instead of restricting the investment options of local governments, the federal government should encourage localities to play a greater role in financing much needed public works projects. H.R. 3807 will make tax-exempt finance more accessible to the small localities that depend on tax-exempt bonds to fund their investments. As such, PSA enthusiastically supports the measure and hopes that it can be favorably acted upon.

Again, PSA appreciates the opportunity to testify on H.R. 3807. If we can assist the Committee in any way in their investigation of this vital issue, please do not hesitate to contact us. Thank you very much.

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